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The New Abnormal

American Consumers Are Cutting Back. Except When They're Not

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Opening Remarks



CHINA PHOTOS/GETTY IMAGES

America Sits Out the Race

There are some obvious ways to make the U.S. more competitive with China in clean energy. Why won't the Senate debate them?
By Eric Pooley

Right now the U.S. Senate is conducting a master class on the perils of legislation by rearview mirror. On July 27, when Majority Leader Harry Reid unveiled the "Clean Energy Jobs and Oil Company Accountability Act," the two most powerful clean energy provisions were missing: a cap on carbon emissions from the electric power sector and a national Renewable Electricity Standard (RES), which would require utilities to generate at least 15 percent of their electricity from renewable sources by 2021. For years, business leaders from General Electric's Jeff Immelt to venture capitalist John Doerr have warned that if America failed to pass a comprehensive climate-and-energy bill, the country risked losing the clean energy race to China—sacrificing the jobs of the future in a timid, ill-fated effort to preserve the jobs of the past. Now those warnings are coming true.

Clean energy advocates were angry but not surprised on July 22, when Reid said he was pulling the plug on the carbon cap (page 32). Powerful utilities were withholding support. President Barack Obama wasn't trying to forge a compromise. And key Democratic senators had no appetite for a bill that might cause a modest, short-term increase in electricity prices—potentially endangering some 20th century manufacturing jobs—even if it helps create many more 21st century jobs by making clean energy competitive with coal. The disappearance of the renewable energy standard, however, was a shock. With elections looming, this may be the last chance for years to set the rules of the road for energy investment.

While the carbon cap, at this intensely partisan moment, has exactly zero Republican supporters, at least four GOP senators have signaled support for the RES. Proponents are hoping to introduce it as a floor amendment—and whether or not they have the votes to pass it, this is a debate worth having.

In a meeting with business leaders and environmental advocates early last year, Obama economic adviser Larry Summers described a "scissors" approach to economic recovery, according to several people who were present but not authorized to discuss it publicly. The first blade of the scissors, Summers explained, was the stimulus package and its tens of bil-

lions for clean energy deployment. The second blade would be a mandatory, declining cap on carbon, which would remove the investment uncertainty that has hobbled the energy market, and draw billions of private dollars off the sidelines. Utility chief executive officers such as Lew Hay of NextEra Energy, Ralph Izzo of PSEG, and Jim Rogers of Duke Energy have all said they are ready to invest in clean energy just as soon as Congress establishes a carbon cap that creates a clear, steady price signal for dirty fuel–in effect, pricing in some of the social costs of carbon pollution that have never been part of America's energy bill.

The scissors is missing a blade. The Senate has made clear it is not ready to cap carbon, and President Obama has made clear that he won't go to the mat for it now, either. On July 24, when some of the clean-tech industry's leading executives gathered in Aspen, Colo., for a Clean Energy Economy Roundtable sponsored by the Aspen Institute, the group was perplexed. "The deployment rate of renewable energy projects in America is withering," said Andy Karsner, CEO of Manifest Energy and a former Assistant Secretary for Energy Efficiency and Renewable Energy during the George W. Bush Administration. "Projects announcements are happening, but largely at the end of a federal check."

Instead of funding U.S. projects, banks and venture capitalists increasingly are putting their energy money into China, where the market is large and secure,

U.S. clean energy "project announcements are happening, but largely at the end of a federal check"

thanks to government mandates. In the second quarter, for example, China attracted more clean-tech asset financing than Europe and the U.S. combined, according to data compiled by Bloomberg New Energy Finance (BNEF). Financing of wind turbines, solar panels, and low-carbon technology in China climbed to $11.5 billion, a 72 percent jump from the year-earlier quarter. U.S. investment in clean energy for the quarter measured $4.9 billion; Europe's, $4.5 billion. "Where investors are placing their bets," says BNEF Chief Executive Michael Liebreich, "is changing rapidly."

On the same day that Reid pulled the plug on the carbon cap, China Daily announced that the People's Republic would begin an experiment in carbon trading–a policy mechanism invented in America, used by Republican George H.W. Bush to fight acid rain, and vilified by today's GOP as "cap and tax." China may spend $738 billion over the next decade developing cleaner sources of energy, according to Jiang Bing, head of the planning and development department for China's National Energy Administration. "The government is taking the issue of cleaner energy seriously for the reasons of climate change [and] energy security," says Barbara Hon, an analyst at China Everbright Securities in Hong Kong. "It's already meeting some of its targets for sectors like wind power well ahead of schedule."

It may already be too late to catch the Chinese, though there are ways the U.S. could stay in the game. The carbon cap would be Plan A, but that's off the table for now. Plan B would begin with passage of the RES and other measures also not being considered in current legislation. One such idea is a "Green Bank" that would leverage Treasury Dept. money for low-interest loans to projects that can't attract conventional financing because their path to profitability is too long. "I don't know if it really amounts to a Plan B," says Kenneth Berlin, a Green Bank proponent and cap-and-trade supporter who heads the environmental practice at Skadden, Arps, Slate, Meagher & Flom. "It's more like Plan D, but it would be far, far better than nothing."

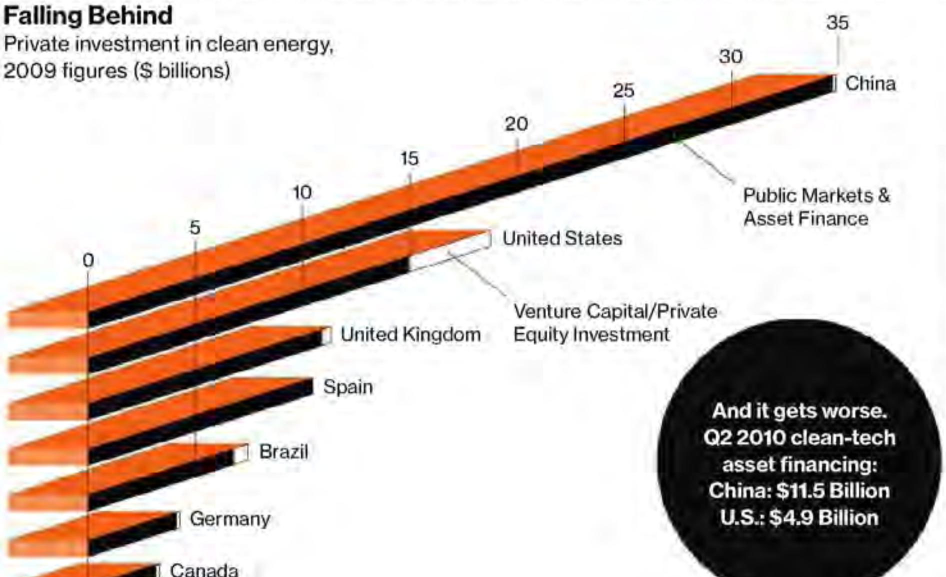
Twenty-eight states and the District of Columbia already have RES laws, many with much higher targets than the one cut out of the Senate bill. Colorado voters approved one in 2004, and the state has increased the standard twice: The current target is 30 percent by 2020, double the one left out of the Senate bill. Colorado now generates almost 6 percent of its electricity from wind, and its commitment to clean energy has helped develop a solar industry as well: from 100 companies in 2007 to more than 400 today, according to the governor's office. When Vestas Wind Systems, the Danish turbine maker, chose to build its North American manufacturing plants in Colorado (a $1 billion investment that was good for 2,500 new jobs), it called the RES a major factor in the decision.

Another early adopter is Texas. Its RES, signed into law by Governor George W. Bush in 1999, has helped the state become a major producer of U.S. wind power, adding almost 10 gigawatts (up from 0.2 in 1999) and thousands of new jobs in the decade since the law was enacted. Although Texas has reduced its carbon emissions as a result of this push into wind energy, Bush and his fellow Texans didn't create the industry because they were worried about global warming. They did it because there was money to be made.

There still is. And if Congress doesn't hurry, most of it is going to be made in China. — *With Jessica Ng*

Falling Behind

Private investment in clean energy, 2009 figures ($ billions)



DATA: BLOOMBERG NEW ENERGY FINANCE


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Global Economics

Inflation: The Great New Divide

▸ Capital from the low-growth West fuels price increases in Asia

▸ "The gap in growth rates is a long-term condition"

For most of the post-World War II era, the U.S. was the locomotive that pulled the global economy out of recessionary valleys. This time it has been emerging-market nations, mostly Brazil, China, and India, that have surged, carrying the U.S. along like a big, fat caboose. Exports accounted for a little more than half of the growth the U.S. economy managed to generate in late 2009 and early 2010, according to data compiled by the Commerce Dept. About 40 percent of U.S. exports went to emerging markets.

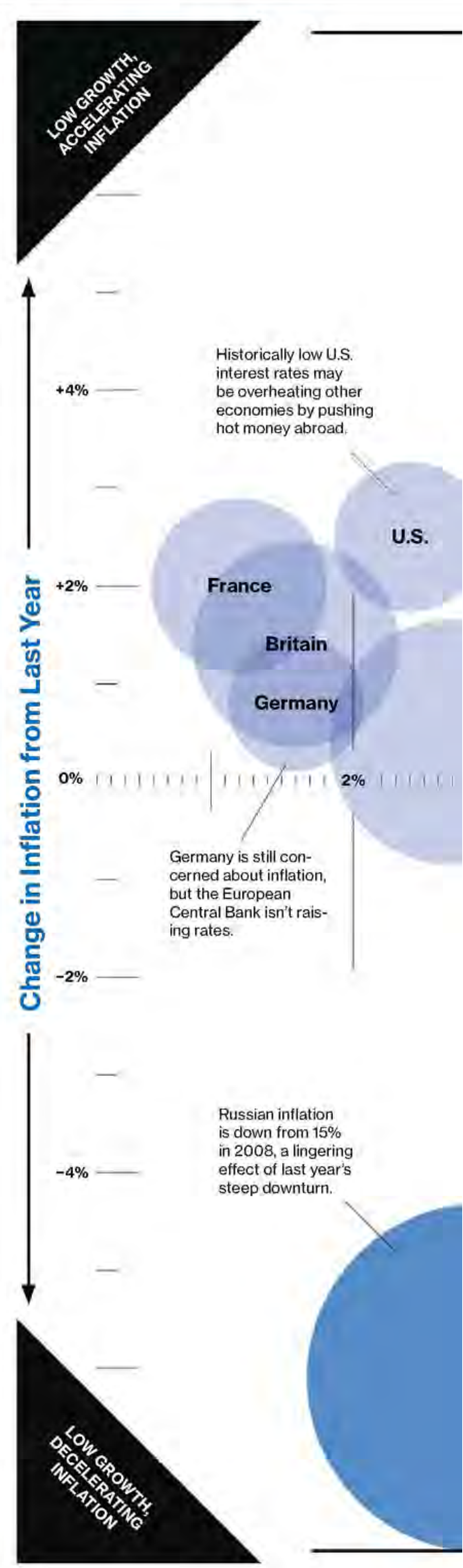
Now inflation in emerging markets—and near-deflation in developed economies—could slow the growth train. Rapid expansion is driving up inflation and generating asset-price bubbles in China, India, and other fast-rising economies. In a sign of how entangled the global economy is, capital from the developed bloc may also be stoking the inflationary fires in those and other countries. Chinese and Indian policymakers are trying to cool things by curbing government spending, raising interest rates, or both. If they accidentally crack down too much, they won't be able to play the role of locomotive. That would be a blow to a U.S. economy that is already threatened with a pause or, at the extreme, a double-dip recession. Also at risk are Japan and Western Europe, which, like the U.S., are wealthy but slow-growing and facing deflationary pressures.

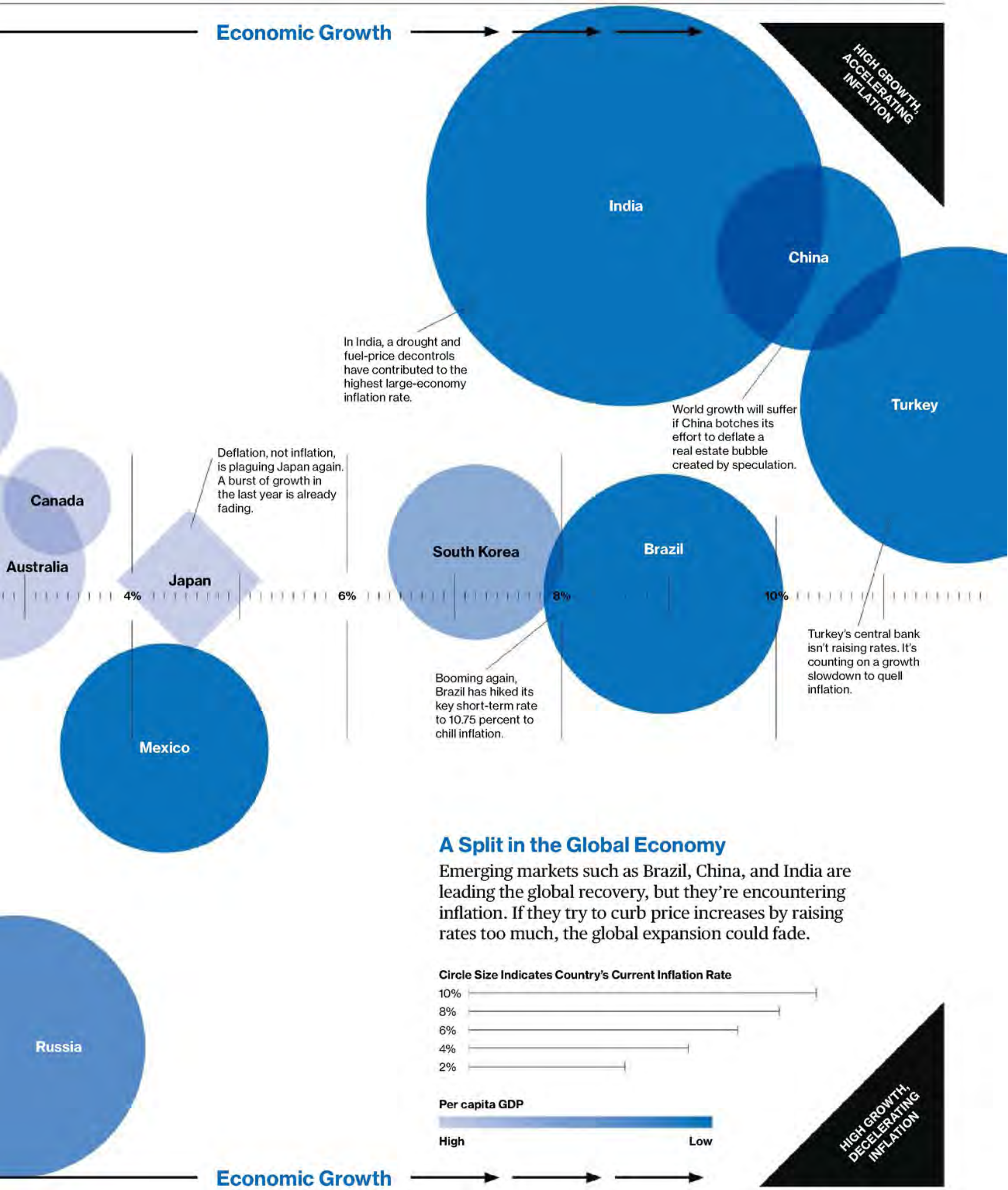
Economist Edward Yardeni regards the divergence between the world's inflationary and near-deflationary zones as one of the key threats to the global expansion. "If the central banks in the [emerging-market countries] are forced to tighten their monetary policies to dampen inflation, their growth rates could be depressed," he wrote in his newsletter in mid-July. "The inflation problem is in exactly the countries you don't want an inflation problem," he adds in an interview with *Bloomberg Businessweek*. The challenge won't go away soon because emerging markets are likely to remain the world's growth engines for years to come. "The gap in growth rates is a long-term condition," wrote Stephen King, chief economist of **HSBC** in London, in a July 26 e-mail.

The accompanying graphic tells the story of a divided world. On the right are large, light-colored bubbles representing India, China, Turkey, and Brazil. These are countries with relatively low incomes, rapid economic growth, high inflation rates, and increases in inflation over the past year. The other prominent cluster is the wealthy nations in North America and Western Europe, plus Japan and Australia. They have higher incomes, slower growth, lower inflation rates, and smaller increases in inflation. Japan (diamond-shaped) is the only country suffering outright deflation. Russia's big drop in inflation makes it an outlier, befitting its halfway position between the rich and poor nations.

Domestic factors such as constraints on manufacturing capacity and labor shortages are the biggest reason for emerging-market overheating. The Federal Reserve, by keeping U.S. interest rates ultra-low, may inadvertently be adding to the problem. The Fed could be feeding bubbles in emerging markets by inducing global investors

Inflation in emerging markets and near-deflation in developed economies could slow the growth train





A Split in the Global Economy

Emerging markets such as Brazil, China, and India are leading the global recovery, but they're encountering inflation. If they try to curb price increases by raising rates too much, the global expansion could fade.

DATA: BLOOMBERG, WORLD BANK

to move money out of the U.S. and into countries that offer higher yields, says Jon Levy, an analyst for Eurasia Group, a think tank. Two-year government notes yield 12 percent in Brazil, vs. about 0.6 percent in the U.S. Says Levy: "The response to deflation pressures in the U.S. creates inflation pressures elsewhere."

The official inflation numbers can mask serious problems. Chinese consumer prices rose 2.9 percent over the past year. In Beijing, though, inflation-adjusted land prices have increased nearly 800 percent since the start of 2003, with half that increase in the past two years, according to research by Joseph Gyourko of the University of Pennsylvania's Wharton School and Jing Wu and Yongheng Deng of the National University of Singapore.

Sam Finkelstein, global head of macro strategies for Goldman Sachs Asset Management, says he's optimistic that officials of major emerging-market nations will avoid a serious slowdown. Americans had better hope so: The annualized U.S. growth rate of the Economic Cycle Research Institute's U.S. Weekly Leading Index fell in mid-July to its lowest point since early 2009. "It's never been here before without there being a recession," David Rosenberg, chief economist of Gluskin Sheff & Associates, a Toronto money management firm, wrote on July 26. Time for the emerging markets to come to the rescue.
—*Peter Coy*

The bottom line *The world economy is evolving into inflationary and near-deflationary zones. Emerging markets must slow down without crashing.*



1.5
MILLION

Workers in Germany's short-work program last year

Unemployment

The Price of Saving Jobs in Germany

- **Shorter hours, government subsidies—it's just like 1924**
- **"We won't see a mass of new hires as in previous upswings"**

Germany's "short-work" policy, which allows companies to put workers on reduced schedules rather than lay them off, showed the world how to survive a recession without losing jobs. It turns out there's a trade-off: As the economy recovers, it looks like hiring will be sluggish. That could stymie household spending and slow growth.

While the worst recession since World War II pushed up unemployment in the U.S. to 10.1 percent, a 27-year high, in Germany the rate fell well below 8 percent, a 17-year low. Last year the government subsidized employers, including **Siemens** and **Volkswagen,** so they would keep employees working at reduced hours rather than fire them. Almost half a million jobs were saved, a feat Chancellor Angela Merkel recently called a "minor miracle."

Under the short-work, or *Kurzarbeit,* plan, companies can temporarily move employees onto shorter work schedules when demand is weak. The companies pay only for the hours worked, while the government provides up to 67 percent of the workers' remaining wages. The program supported up to 1.5 million employees at some 63,000 companies, according to the Federal Labor Agency. In March, the latest month for which data are available, some 693,000 people were still working fewer hours.

The short-work idea dates to 1910, when the government compensated workers who faced a slump in the potash and fertilizer industry. In 1924, when unemployment reached 11 percent, the government introduced nationwide short-work policies similar to those today.

Another tool that has contained unemployment is the work-time account, which allows German companies to reduce employees' working weeks during downturns. Later, when order books fill up, the companies don't have

Quoted

"If there's one thing we haven't seen loosen up, it's credit availability for mid-to-small contractors. Their local and regional banks, virtually all their credit sources, have been a lot tighter than we've seen in the past at this stage of the recovery."
—Caterpillar CEO Douglas Oberhelman





to pay overtime–employees work the hours they lost during the downturn and get paid ordinary wages. **Trumpf**, a maker of machine tools, electronics, and lasers, has such an agreement with its unions: Employees work up to 250 hours more than contractually agreed when business soars and up to 250 hours less when demand is low. When orders collapsed in November 2008, the Ditzingen-based manufacturer exhausted this 500-hour buffer, then switched about 3,200 of its 4,500 workers in Germany onto the government's short-work program. "It was our top priority to keep our core workforce and preserve knowledge and experience," says Trumpf Executive Vice-President Gerhard Rübling. "We had layoffs in foreign markets with less flexibility, such as Spain, Poland, and, partly, the U.S."

The downside is that companies won't need to hire for some time. Labor agency chief Frank-Jürgen Weise says companies cut working hours by an average of 30 percent in the recession; they can soak up those hours before having to hire again. "We won't see a mass of new hires as in previous upswings," he says. His agency estimates that employment will rise next year by just 30,000 to 50,000 jobs.

Without new hiring, consumer spending in Germany will likely remain sluggish, and the economy is expected to expand less than 2 percent this year and next. "Short-time labor certainly helps to shoulder a temporary loss of work in times of crisis," says Andreas Rees, chief German economist at UniCredit MIB in Munich. "But it's not a panacea. There's no job-market miracle."

—Christian Vits and Jana Randow

The bottom line *With help from the government, German companies managed to save half a million jobs. Hiring new workers may prove difficult.*

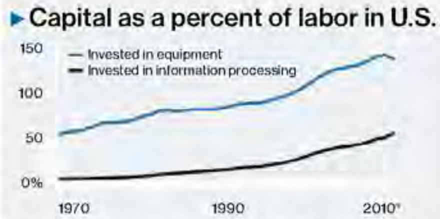
FROM TOP: SEAN GALLUP/GETTY IMAGES; KEVIN LAMARQUE/REUTERS

Productivity

Machines Don't Get Paid Overtime

▶ The capital-labor ratio helps explain why the jobless rate is so high

▶ Capital as a percent of labor in U.S.



DATA: OFFICE OF ECONOMIC ANALYSIS, BLS. *ESTIMATE

The recession, economists say, technically ended in mid-2009. A year later the unemployment rate is still stuck above 9 percent, and it may take until 2012 for it to reach 8 percent, according to a survey of economists by Bloomberg News. The general explanation for this stubbornly high rate is that companies face an unprecedented era of uncertainty, with questions on the impact of health-care reform, the strength of the real estate market, and the cost of financial regulations all remaining unanswered. Until companies get clarity, they will be reluctant to hire new full-time employees.

The job crisis could be seen another way: as a continuation of a trend that started 20 years ago. Before 1990, recessions in the U.S. followed a similar pattern. The downturn would end, and companies would start adding jobs in a little more than two months, according to the National Bureau of Economic Research. In 1990-91 hiring began outpacing firing three months after the end of the recession. It took seven months after the 2001 recession's technical end before hiring trends turned positive, and 27 months before companies hired in large enough numbers to cut seriously into unemployment. This time the lag is even longer.

Economist Allen Sinai, who runs the consulting firm Decision Economics, has an explanation for this emerging pattern. He sees the capital-labor ratio–total capital invested as a percentage of hours worked–as the key to the puzzle. Capital spending boosts productivity and, in the short run at least, often eliminates the need for extra workers on the factory floor or in the office.

When the ratio rises, it shows companies are spending more on labor-saving machinery than on workers. From 1990 to 2008 the overall capital-labor ratio, which includes investments in factories and other buildings, increased by 29 percent, according to the Bureau of Labor Statistics. The ratio for capital invested in equipment and information processing rose much faster. The information-processing ratio, for example, shot up 310 percent from 1990 to 2010. "Companies find the all-in cost of U.S. workers–salary, benefits, training–very high," says Sinai. "So if you can find substitutes for people, it's cheaper."

The stock market plays a role, too, says Sinai. By 1990 the doctrine of maximizing shareholder value had gained wide acceptance at publicly traded companies in the U.S., and executive compensation was by then firmly linked to boosting the stock price. "Stocks always respond positively when head count is permanently reduced," says Sinai, "because profits are then expected to come in higher. We are the only country where the mantra of maximizing shareholder value is so intense." Sinai figures that reducing the role that stock options play in compensation could make executives less likely to shrink payrolls so much. Until these pay incentives are changed, and until U.S. workers become less expensive, high unemployment could be a chronic problem.

—Christopher Power

The bottom line *The recovery in hiring is elusive. Companies are finding that buying equipment is cheaper than adding people.*

Diplomacy

Cameron Backs the Turks, Rattles the EU

- The British PM says it's time Turkey got into the European Union
- Germany's response: Istanbul isn't "capable of joining" now

Turkey has a new-old friend in Europe: the British government. Prime Minister David Cameron touted himself as the "strongest possible advocate" of Turkey's bid to join the European Union when he visited Ankara on July 27.

It was an easy call for Cameron, bent on quickening the U.K.'s recession-hit economy by tapping Turkey, a market of 73 million consumers with gross domestic product growth of 11.7 percent in the first quarter. The aspiration is to double U.K. trade with Turkey, to $18 billion annually, by 2015. Cameron's pro-Turkish pronouncements also fit in with a long-standing U.K. policy of promoting an ever-wider EU, so the bloc evolves into a loosely organized free-trade zone that isn't dominated by Germany, France, or the unelected mandarins of Brussels.

The trouble is that Turkey's quest to join the world's largest commercial bloc has gone virtually nowhere since entry negotiations began in 2005. For a while, that was because of opposition in Europe, led by Cyprus, Turkey's Greek-speaking rival in the Mediterranean. The mood soured further when Angela Merkel became German chancellor and Nicolas Sarkozy was elected French president. Both want Turkey to model its economy on Europe's and develop ever-closer ties with the EU. That doesn't mean they want the predominantly Muslim nation to become a member. The French and Germans think of the Turks, whose per capita GDP is less than half the EU level, as too "other" to fit comfortably into the club. Because of Turkey's large population, it would also play a powerful role in the European Parliament and demand its share of EU resources.

Just after Cameron left, Germany's Foreign Minister, Guido Westerwelle, showed up in the Turkish capital with a contrary opinion: Turkey isn't "capable of joining" now, and the 27-nation EU isn't ready to let it in, he told the German newspaper *Bild*.

The Turks are responding to the heightened debate. Under Islamist-leaning Prime Minister Recep Tayyip Erdogan, the country, known as the "sick man of Europe" in the 19th century, is rapidly gaining. After a decade of strong economic growth, Turkey is reemerging as a regional power, forging links to Iran, Russia, the Caucasus, and central Asia. Turkey has become a Middle East power broker, too, and is even threatening to break a decades-old alliance with Israel over the Israeli attack on the Turkish-backed Gaza aid flotilla in late May.

EU membership is no longer Turkey's No. 1 priority. It ignored the tradition of would-be members falling in line with EU foreign policy when it voted against sanctions on Iran's nuclear program in the U.N. Security Council in June. It did an end run around Western governments and teamed with Brazil, another ascending economy, to engineer a uranium swap for Iran, in which Iran would ship much of its enriched uranium to those countries for further processing. As for Britain, Erdogan eyes a "golden age" for British-Turkish relations–without Brussels as the middleman.

—*James G. Neuger*

The bottom line *British Prime Minister David Cameron has called on the EU to let Turkey in. The French and Germans beg to differ.*



Erdogan and Cameron reviewing troops in Ankara

UMIT BEKTAS/REUTERS

14

Stimulus

Where China Hides Its Debt

- Cities can't borrow much. Specially designed companies can
- "A lot of this is being invested in money-losing projects"

Victor Shih is a professor of political science at Northwestern University who spends his days scouring the Chinese Internet, looking for signs of financial trouble. Shih explores obscure Chinese government sites for announcements of loan agreements between China's state-owned banks and local investment companies (LICs). These companies borrow on behalf of local governments whose own ability to borrow is legally limited. Officially, there are more than 8,000 LICs. Beijing encouraged their development over the past two years as a way to disseminate funds quickly to projects.

Now, Shih is worried that the LICs have borrowed more than they can pay back. Chinese officials share his concern. "The soundness of the banking sector is being tested," Liu Mingkang, the top bank regulator, warned in June. He cited lending to "local government financing platforms"–or the LICs–as one of the big risks the banks face.

Many of the LICs have borrowed heavily to back the building of roads, railroads, and power plants, as well as hotels, convention

→ 18

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Global Economics

Are Red Sox tix really red-hot? page 24 ▶

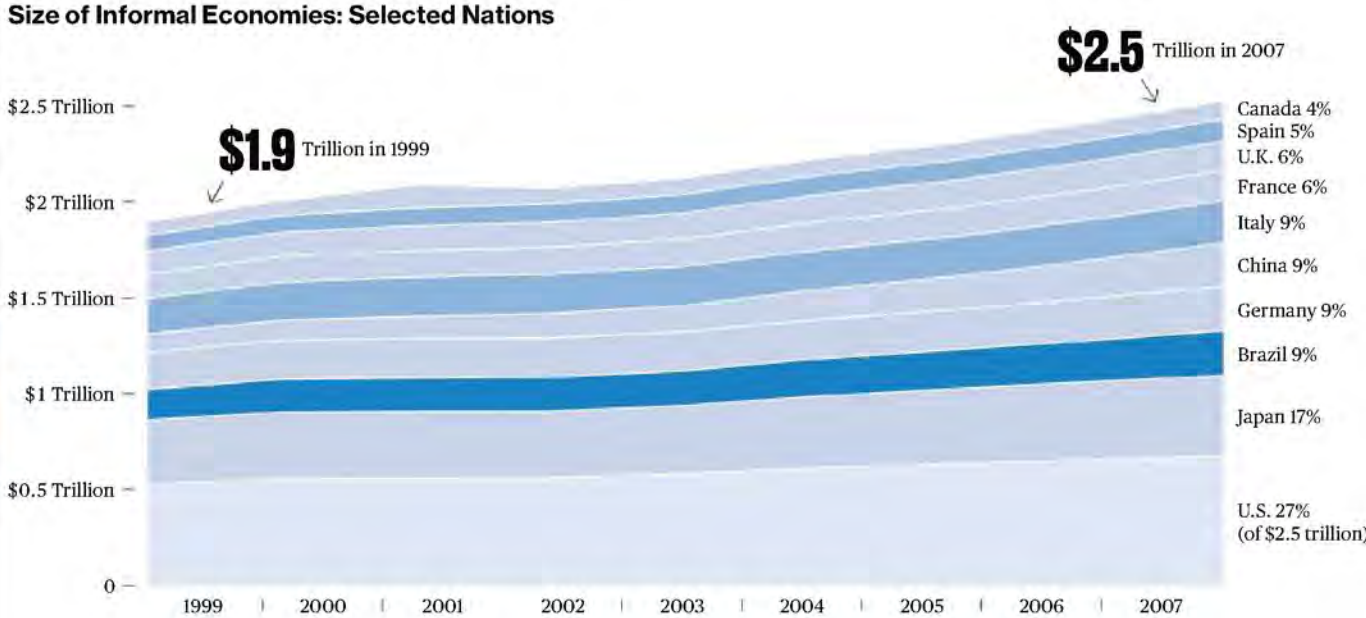


Taxes

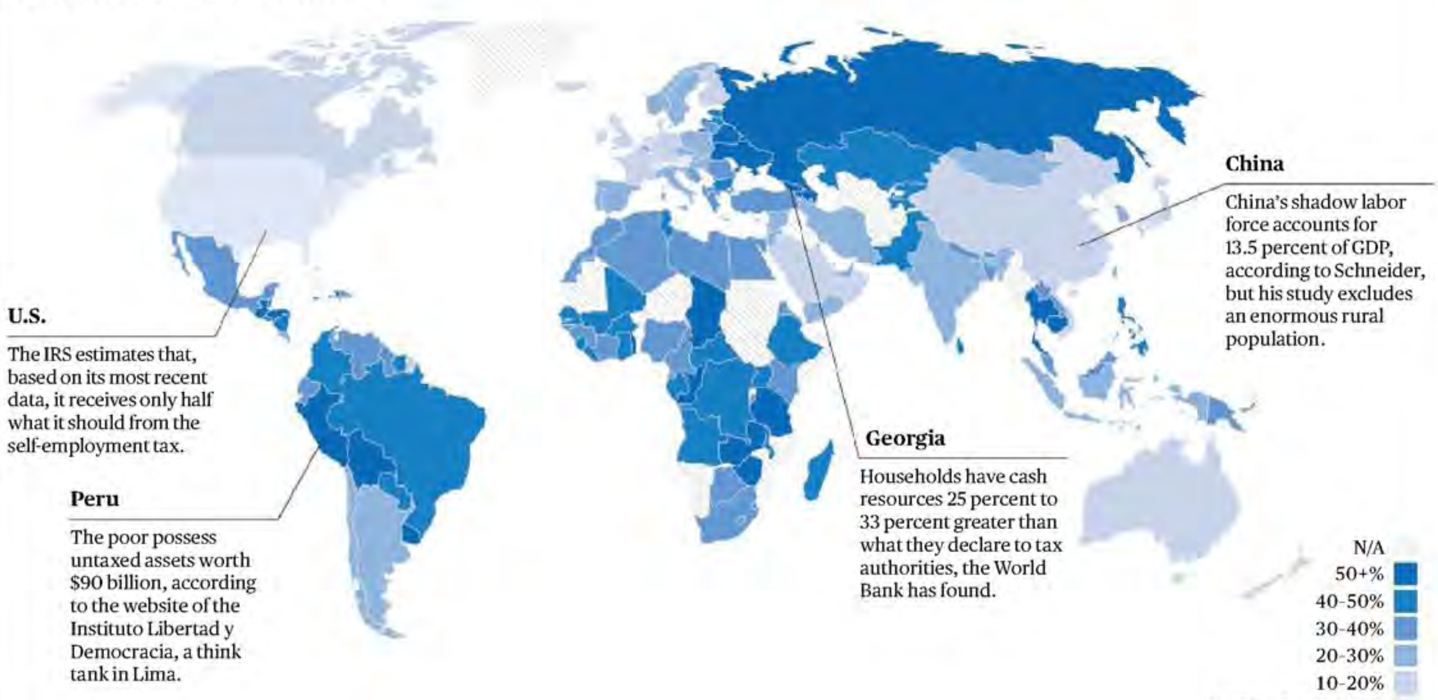
The Underground Economy

The global shadow economy–activity that isn't necessarily illegal but goes unreported–amounts to almost 35 percent of the world's official GDP, according to Friedrich Schneider, a professor at the University of Linz in Austria and an authority on the topic. In a June report, Schneider examines informal economies, which range from 9 percent of GDP in the U.S. to more than 70 percent in Bolivia and Georgia. The report takes into account such activities as undocumented immigrant labor, home businesses, and freelancing that escape the attention of tax authorities. It doesn't cover drug trafficking and other criminal enterprises.

Size of Informal Economies: Selected Nations



Worldwide Informal Economies

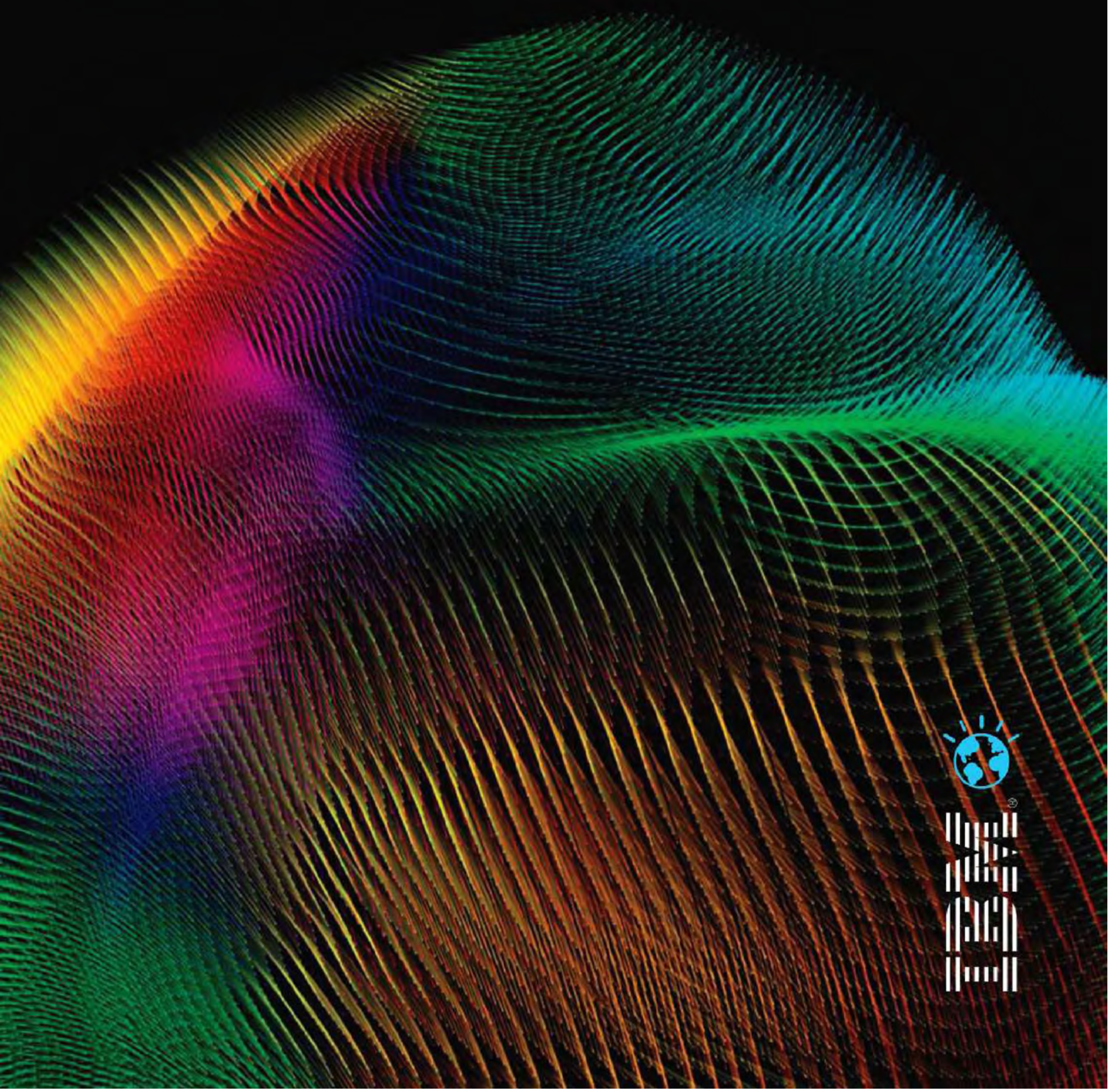


DON HEUPEL/AP PHOTO

How fast does a system have to be to capture a business opportunity?

How do you cut costs without cutting results?

How do you benchmark intelligence?





A building spree in Yinchuan has brought an Empire State Building copy ...



... a glittering science and technology center ...



... and an impressive library to the capital of Ningxia autonomous region

centers, office buildings, and more. While some LICs have gotten land from local governments that they can use as collateral, many banks must rely on pledges from local city halls that the loans the LICs secured will be repaid. Shih figures outstanding LIC debt at the end of 2009 was $1.68 trillion—34 percent of China's gross domestic product. "A lot of this money is being invested in money-losing infrastructure projects [as well as] real estate," says Shih. Western investment firms are wondering what impact the LICs will have on Chinese banks if they cannot pay back the bulk of their debts. "Unfortunately, this smells like China's last banking crisis," says Shen Minggao, an Asia-Pacific economic analyst with **Citigroup.**

Figuring out what projects the LICs have financed and how healthy they are is hard. Shih says LICs in the western city of Yinchuan, the capital of Ningxia autonomous region, have helped bankroll a building spree. New luxury villas and high-rise residential complexes, as well as a huge new soccer stadium, adorn the city. A science and technology center, a museum, and a library each occupy several football fields' worth of turf, while an almost-finished skyscraper resembles New York's Empire State Building. It's pretty ambitious for a region that depends on cash transfers from Beijing for 70 percent of its total revenues. Shih estimates Ningxia's debt at $15 billion–75 percent of the region's economy. "A soccer stadium in the middle of nowhere is not going to generate much cash flow," he says. "Without massive central government subsidies, I think many of these projects will not generate enough cash even to pay interest on their loans."

Local officials say there's no problem, and that a healthy mix of bank funds, corporate bonds, grants from Beijing, and investment from state enterprises has pumped billions into Ningxia. "This shows how much importance the central government places on developing the west, and Ningxia benefits from that," says Shao Xiaowen, an official from the local development and reform commission.

In June, China's State Council ordered local governments to guarantee that their investment vehicles were able to repay their debts. The localities were also told to finish projects under way before starting new ones. "The biggest concern is that harsh implementation of these new rules would leave many [local governments] with half-finished projects and no prospect of servicing their debts," wrote Mark Williams, senior China economist at **Capital Economics**, a London consultancy, in a July 8 report.

Beijing could also opt to ignore its own edicts and stick with easy lending. In early July central government officials said they would continue the Develop the West program for 10 more years and budgeted $101 billion for 2010 alone. China is loath to tap the breaks too suddenly, particularly in the west, home to migrant workers, peasants, and restive minorities. Risk a bank crisis by lending too freely? Or court recession and upheaval by cutting off the funds? It's a hard choice. B

—Dexter Roberts, with Andreea Papuc

The bottom line *Special financing companies in China have borrowed almost $2 trillion. Concerns are rising about their ability to pay it all back.*

Tom Keene's EconoChat

Tom talks with **Jim Grant,** editor of *Grant's Interest Rate Observer,* on the slow economic recovery

You have persistently called for higher interest rates. Why?
You know, there is a great emphasis now within the Federal Reserve on consumer protection. And I think a nice way to protect the consumer is to give the consumer a rate of return on his or her savings greater than zero. The great paradox to me of the Fed's obsession with consumer protection is that the one thing it can control—that is to say, its own federal funds rate—is stuck very close to zero.

Is it an elite policy? Are they doing it off Ben Bernanke's study of the Thirties, which stressed saving the financial institutions but not savers?
I am not sure I would call it elite. I think I would call it misplaced. I'm not sure Chairman Bernanke has any greater love for JPMorgan than he does for the average saver. Maybe there are only six or eight savers in America left, in which case he is playing to a much bigger constituency on Wall Street.

Why can't we just do what we need to do—let banks fail, let housing prices reach their right level, allow foreclosures to run their course—and get things moving again?
In the depression of 1920-21, the Fed actually tightened, exactly what the Fed is not doing now. That depression was brutal, but it was over in 18 months. Today, by refusing to let markets clear, by refusing to say "let's just see where prices would be in the absence of meddling," what we do is prolong the agony. We are stuck with the Japanese approach. B



Keene hosts Bloomberg Surveillance *7-10 a.m., 1130AM in New York, XM 129, Sirius 130.*

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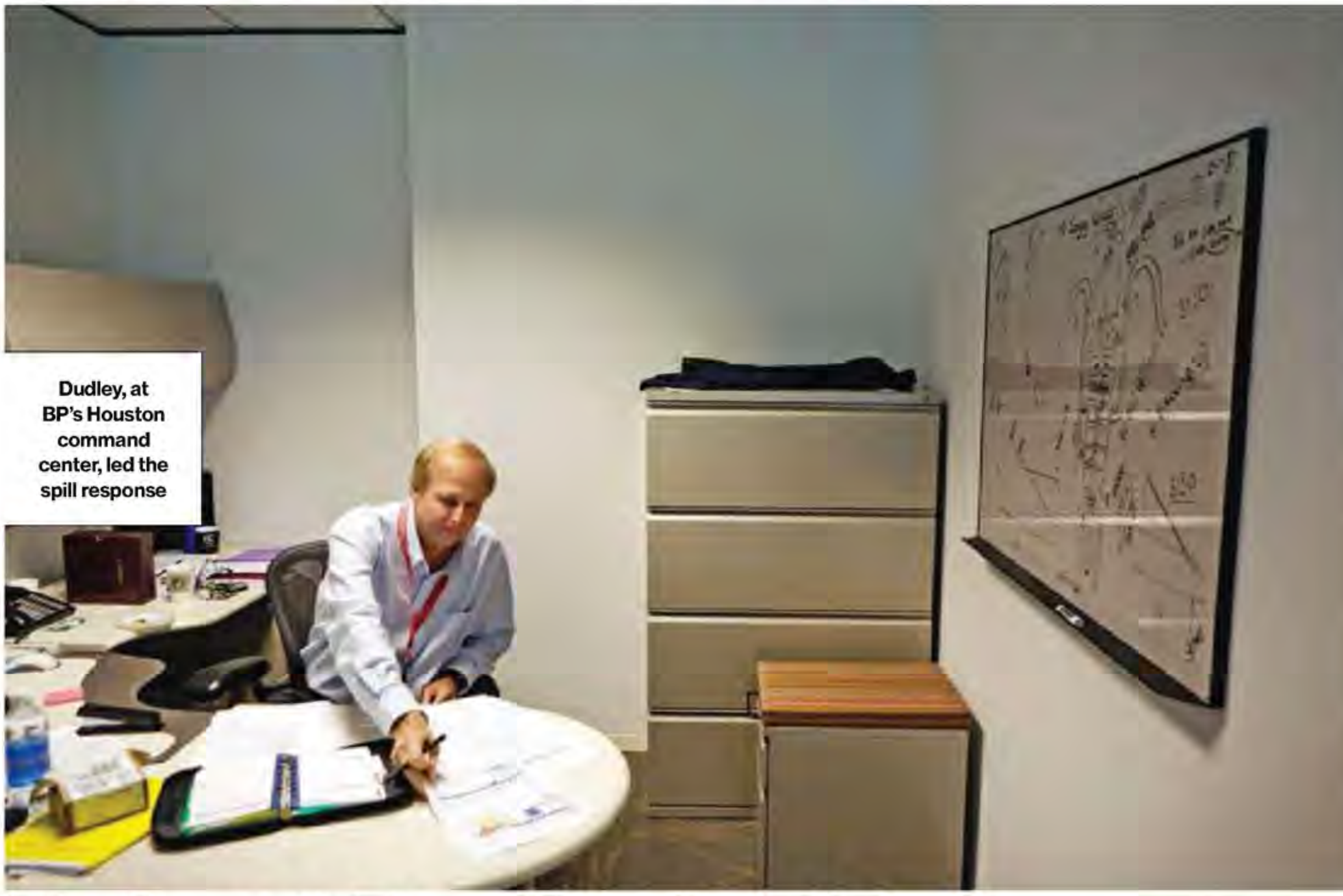
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Companies&Industries



Dudley, at BP's Houston command center, led the spill response

MICHAEL STRAVATO/POLARIS

Robert Dudley's BP Could Be Riskier Than Ever

▶ **The embattled oil giant's first American CEO embraces a high-risk survival plan**

▶ **"It's not our intention to exit the U.S., nor do we believe we won't be able to operate there."**

Robert Dudley, the man charged with righting **BP**, won't sound a retreat. Despite the disastrous blowout in the Gulf of Mexico, BP will plunge even deeper into deepwater exploration. Dudley, who becomes the first American chief executive officer of the British oil giant on Oct. 1, will slim BP to its core strength: the high-risk, high-return search for oil and gas in demanding environments. That's the same strategy that led to the Gulf spill and turned outgoing CEO Tony Hayward into a pariah. It remains alluring because it can generate large profits for companies that avoid calamity. "The key to this industry is replacing earnings, and BP thinks they know how to do that in deep water," says J. Robinson West, chairman of consultant PFC Energy in Washington.

Dudley, 54, doesn't have much choice but to make the company leaner. He needs cash to reassure financial markets of BP's viability and to pay gigantic bills for the spill. Along with announcing Dudley's new role, BP on July 27 took a $32.2 billion charge for estimated future spill costs. That led to a loss of $17.2 billion for the second quarter. To raise cash, Dudley surprised investors with plans to sell up to $30 billion in production assets–triple the level company executives in May said they would divest. BP's oil and gas production will fall from 3.8 million barrels per day to about 3.5 million.

What's on the block are mostly old onshore or shallow-water fields such as Alaska's Prudhoe Bay, where output is declining. The sales will heighten BP's dependence on deepwater fields, which already account for about 18 percent of its output. Stripped of its plain-vanilla oil fields, BP will be closer to what Wall Street analysts have long wanted it to be: an aggressive exploration play dependent on big finds in deep water such as the coastal waters off West

Companies&Industries



Pelosi's business brain trust page 28 ▶

Africa and in the Gulf. That's why it is so important for BP to stabilize its key U.S. business. The Gulf accounts for 11 percent of its production; the oil it extracts there is among its most profitable.

A company spokesman says management was happy over the $7 billion that **Apache**, a mid-size company, agreed on July 20 to pay in BP's first round of asset sales. Those oil and gas properties constitute about 2 percent of BP's production. The price was more than double BP's in-house valuation of the properties. Hayward said the deal effectively valued BP's total exploration-and-production business at $350 billion—almost three times the company's depressed $119 billion market capitalization.

Dudley won respect for the coolness he displayed under fire in Russia, as head of BP's turbulent joint venture, **TNK-BP**. He got the nod to lead the entire company at least in part to placate U.S. politicians and dissuade them from barring BP from drilling in American waters. BP is the biggest player in the Gulf's deepest waters, and its future depends on being able to hold on to its position there. Dudley, who grew up in nearby Hattiesburg, Miss., has been in charge of the Gulf cleanup effort. He spent half of his career at Amoco before it was acquired by BP in 1998. "It's not our intention to exit the U.S., nor do we believe we won't be able to operate there," he said on July 27.

Fortunately for BP, other countries with deepwater reserves, such as Angola and Egypt, have thus far refrained from restricting the accident-prone company. Dependent as they are on oil and gas revenue, these states don't wish to disturb a lucrative relationship. Dudley even sees an upside for the company, which he said could wind up with "higher-quality assets and growth" from its reliance on higher-risk exploration. Says Gianna Bern, president of Brookshire Advisory & Research: "In the years to come they certainly have the potential to have higher profitability on a per barrel basis."

Still, that future could be difficult if Dudley, like Hayward before him, falls short on his pledge to strengthen BP's safety program. "There is no room for error here," says Oppenheimer & Co. analyst Fadel Gheit. —*Stanley Reed, with Brian Swint and Joe Carroll*

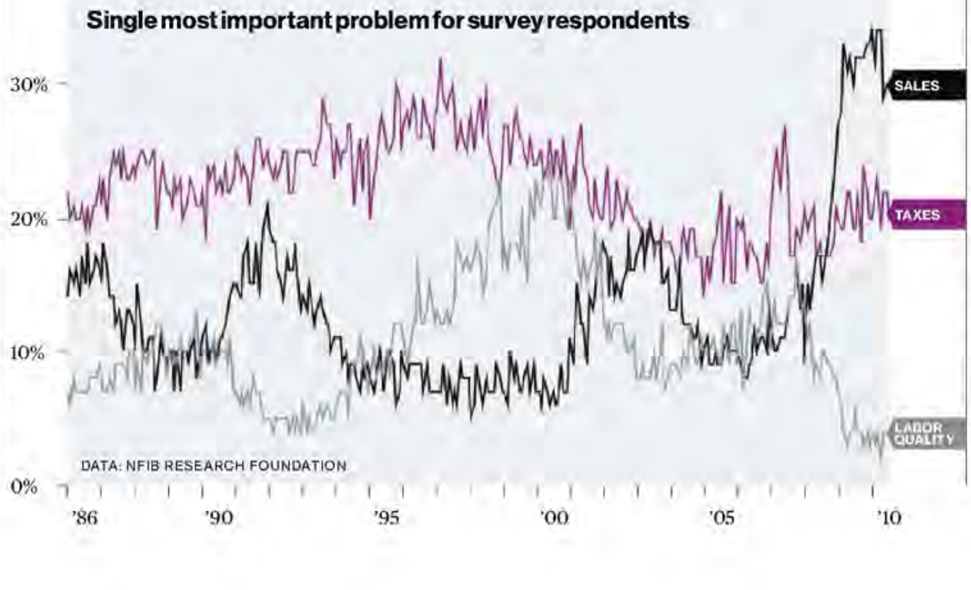
***The bottom line** A trimmed-down BP won't back away from risky deepwater drilling; the business is simply too lucrative.*

Small Business

The Recession Stokes Revenue Worries

Taxes had long been the No. 1 concern of most small business owners. A June 2010 survey by the National Federation of Independent Business shows that worries about poor sales have eclipsed entrepreneurs' perennial concerns over Uncle Sam taking his due. —*James E. Ellis*

Single most important problem for survey respondents



Profits

The Earnings Rebound May Be Misleading

▶ Despite upbeat second-quarter profits, problems linger for the U.S.

▶ "The more attached to consumers you are, the more risk"

On the surface, the flood of better-than-expected second-quarter earnings reported in July might suggest that a rebound for U.S. business is in full swing. More than three-quarters of companies that had announced results by July 27 topped Wall Street profit predictions. Operating margins—a much watched measure of profitability—were running at an average of 11.6 percent, compared with a more typical 7 percent. Big corporations such as **Honeywell**, **UPS**, and **FedEx** are also forecasting more black ink in the months ahead.

There's plenty of sobering news, however, lurking within the upbeat pronouncements. Many executives are generating stronger profits by wringing costs out of their businesses rather than by expanding revenues. Most of the quarter's earnings pops at companies such as **DuPont** reflect overseas operations or exports, not business in the U.S., where consumers remain tightfisted. And for many companies, the quarter's gains were magnified when compared with results in recession-wracked 2009.

"Earnings are nicely up from the second quarter of 2009—no great feat," says Howard Silverblatt, an analyst at Standard & Poor's. But he notes that soaring margins are actually a function of less-than-robust sales growth, since a dollar of earnings is a bigger percentage of $9 in sales than of $10. A fifth of the companies that reported earnings by July 27 fell short of their second-quarter revenue estimates.

Consumers are spending 60 percent of what they normally do during a recovery, according to Bruce McCain, chief investment strategist at Key Private Bank. Restrained consumer spending, along with uncertainty about health costs after the enactment of reform legislation, are contributing to business cautiousness about investing and hiring, he adds. "They're willing to give

THIS PAGE: CAROLYN KASTER/AP PHOTO. OPPOSITE PAGE: DAVID TURNER/BLOOMBERG

up some of their upside to retain their defensive position."

There is some good news about earnings. Exporters to developing markets—the "spark plug" in the recovery, McCain says—have posted profit and sales gains as they help India and Brazil build infrastructure. Almost 72 percent of industrial companies have posted sales that topped estimates, compared with 61 percent of all companies. Equipment maker **Caterpillar**, which generates 67 percent of its sales from outside the U.S., reported second-quarter sales that beat estimates and boosted its 2010 earnings outlook. Caterpillar cited higher demand for construction gear in developing countries.

A similarly upbeat vibe characterizes many foreign units of big American companies. Columbus (Ga.)-based **Aflac**, which gets most of its revenue from insurance sales in Japan, saw its second-quarter profits surge 85 percent, thanks to strong health and life policy sales there. And DuPont's sales in the Asia-Pacific region surged 47 percent, vs. an 18 percent rise in the U.S.

So far, though, it's unclear when the domestic U.S. business climate will improve markedly. Corporations that serve business customers seem to have the edge. Computer printer maker **Lexmark,** for example, reported that its second-quarter earnings more than doubled. "The reason Lexmark is growing is our enterprise [corporate] business is growing," says Chief Executive Officer Paul Curlander.

It's a different story for businesses focused on consumers. **CVS Caremark**, the largest U.S. provider of prescription drugs, on July 28 cut its 2010 forecast on worries that fewer consumers would seek medical care because of the still-weak economy. That caution is echoed by executives across U.S. industries.

"The business-to-business side is pretty good," explains Kurt Kuehn, chief financial officer of UPS, which saw second-quarter earnings jump 90 percent, in part because of a big boost in business shipments in Asia. "The consumer is another question. The more attached to consumers you are, the more risk." *—Katie Hoffmann, with Roben Farzad, Mike Dorning, Mary Jane Credeur, and Arik Hesseldahl*

The bottom line *U.S. companies are reporting strong second-quarter profits; there are reasons to question how promising the results are.*



Family Dollar is adding more name-brand items to attract shoppers

Retailing

Came for the Bargains, Stayed for the Brands

- Sales at dollar stores are growing while they're falling at Wal-Mart
- "I had thought Dollar General carried cheap stuff"

Wal-Mart Stores is beginning to lose its grip on cash-strapped Americans. **Dollar General**, **Family Dollar Stores** and **Dollar Tree**—three rivals that are the biggest of the so-called dollar store chains—have all seen traffic at their stores tick up this year, while Wal-Mart's U.S. numbers have slipped. "Dollar stores are in a sweet spot," says Bernie Sosnick, an analyst at Gilford Securities in Melville, N.Y. "They're on the wrong side of the tracks, close to the where the lowest-income shoppers live. This puts them in position to do more business with people who are suffering from constrained spending power." Adds Sosnick: "Wal-Mart is flailing."

The Bentonville (Ark.)-based retailer generated revenues of $258.2 billion last year from its 3,700-plus U.S. stores, 10 times greater than the combined sales of Dollar General, Family Dollar, and Dollar Tree, which together have some 19,500 outlets. Yet in the most recent quarter, Wal-Mart's same-store sales sank 1.4 percent, trailing gains of 7 percent by Family Dollar, 6.7 percent by Dollar General, and 6.5 percent by Dollar Tree. "Our key point of difference with our customers is our everyday low price in a convenient location," said Dollar General Chairman and CEO Richard Dreiling during a June 8 earnings call. Wal-Mart won't discuss its competitors, says Greg Rossit-

er, a company spokesman.

A confluence of trends is behind dollar stores' improved fortunes. Squeezed by higher gasoline prices, consumers are forgoing the often long drives to big box stores far from their neighborhoods. "Our traditional shopper is feeling pain," says Jim Kelly, Family Dollar's president and chief operating officer. "When gas prices picked up, they looked for greater value in their basic spending."

Consumers also are being drawn to the stores by an expanding selection of name-brand products. Maria Wildrick, a kindergarten teacher in Carthage, Ill., says she now makes the 35-mile drive to a Wal-Mart in Macomb just once a month but visits her town's Dollar General on a weekly basis, spending $75 on average. "I had thought Dollar General carried cheap stuff, so I was pleasantly surprised," says Wildrick, 54, who stocks up on Nestlé's Fancy Feast food for her cat, Marley.

Family Dollar began building up its stock of name brands during the recession. Its stores now give more space to food, health and beauty aids, and paper products–and less to clothing and other discretionary items. The Matthews (N.C.)-based retailer added more than 100 grocery items in the last quarter.

COO Kelly ticked off some of his recent coups while touring a store in Charlotte: **Campbell Soup**'s Prego pasta sauce, **Kraft Food**'s A.1. steak sauce, and **J.M. Smucker**'s Crisco shortening. "These are names that our customers recognize," he says. "We are broadening our assortment to get more of what our customers are accustomed to buying." Similarly, Dollar General is installing taller shelves so it can accommodate more national brands alongside its own private label food and sodas.

The decline in rents brought about by the real estate glut has spurred dollar stores to expand. Family Dollar is adding 200 stores this year, Dollar Tree 220, and Dollar General 600. Wal-Mart, meanwhile, is slowing its U.S. store openings so it can focus on remodeling its supercenters, which average 185,000 square feet, vs. the 7,000 to 9,000 square feet that is the average for dollar stores. Wal-Mart is also testing smaller formats.

Retail analysts are divided on whether dollar stores can hang on to their new customers once economic times improve. Craig Johnson, president of New Canaan (Conn.)-based consulting firm Customer Growth Partners, predicts that like Wildrick, customers will become hooked once they see dollar stores have evolved. "They've become a new generation of convenience stores, not just a place to buy something on the cheap," he says. Maggie Gilliam, president of New York-based retail consulting firm Gilliam & Co., disagrees. "Most people don't aspire to shop at dollar stores," she says. "As soon as they feel better economically, they'll return to their old stores." —*Chris Burritt*

The bottom line *Dollar stores are adding outlets and boosting their offering of name-brand products to lure shoppers away from big box stores.*

Quoted

"We're not fighting for the highest volume but for the best reputation, customer satisfaction, and the best profit. Whether we'll end up slightly ahead or behind Lexus isn't really relevant."
—Dieter Zetsche, CEO of Daimler, on the prospects for the luxury carmaker to surpass Toyota's Lexus as the No.1 luxe brand in the U.S.





Fenway: On some nights brokers may be left with scores of tickets

Sports Marketing

The Red Sox Nurture A 'Sellout' Streak

- ▶ The team's claim of a perennial full house is questionable, but lucrative
- ▶ When fans say they've got tickets, "the people listening are jealous"

They're called the Fenway Faithful with good reason. On July 18, Boston Red Sox fans streamed into Fenway Park for the club's 600th consecutive sellout, a record run in Major League Baseball that began in 2003. Players, coaches, and principal owner John W. Henry, a hedge fund mogul, marked the occasion by tossing 600 commemorative baseballs into the packed stands.

So you'd think Red Sox seats are nearly impossible to score. Wrong. About 20 to 30 percent of the club's tickets trade on what's become baseball's hottest secondary market, making seats available for every game. Usually that means paying a big premium over face value. But for some games, even when resale prices fall below face value, tickets end up in the trash, never purchased by anyone intending to enter Fenway Park.

Red Sox management says it doesn't contrive sellouts as a marketing tactic. But some economists say the club's practice of keeping ticket prices lower than

THIS PAGE, FROM TOP: ADAM HUNGER/REUTERS; NELSON CHING/BLOOMBERG. OPPOSITE PAGE: PETER BECKER/DPA/ZUMA PRESS

what fans are willing to pay helps fuel the streak. The team easily unloads all of its seats, knowing that many will be resold. The risk of being stuck with unsold tickets shifts to resellers. Explains Craig A. Depken, professor of economics at the University of North Carolina at Charlotte: "Their [official] prices help protect the streak of sellouts, and the sellouts are a great selling point."

Jim Holzman–owner of Boston-based broker **Ace Ticket**, the biggest reseller of Red Sox seats–is happy to do his part for the streak. Before this year's first game, he owned 40,000 tickets to various games, mostly from season ticket holders eager to make a quick profit on a portion, or sometimes all, of their seats. Holzman's 38-employee company resells them at a further markup through its own local ticket stores or online.

Circumstances don't always cooperate. When games fall on cold, rainy April evenings, Holzman says he can get stuck with "hundreds and hundreds" of unsold tickets. The same thing happens for some games in late September if the Sox are playing poorly and are out of contention. Still, no matter how many tickets wind up in the waste bin at Ace and other brokers, the team can claim a sellout–and the streak goes on.

New Englanders have a long-running love affair with the Red Sox and the ballpark John Updike famously described as a "lyric little bandbox." Septuagenarians Barbara and Alan Miller have held season passes for 43 years. "Oh, I'm a crazy fan," Barbara says, from her seat four rows away from the home team's on-deck circle. The bond the Sox enjoy with their fans has grown even stronger since 2004, when the club claimed its first World Series championship in 86 years. They won it all again in 2007.

List prices of tickets at Fenway this season average $52.32, second-highest behind the Chicago Cubs, according to *Team Marketing Report*. But tickets trade at an average of $89 on the online secondary market, the highest in baseball, according to SeatGeek.com, a forecasting website. Ace is asking $1,435 for its best seats ($250 face value) to an Oct. 2 game against the New York Yankees.

The Red Sox say they try to limit the flow of tickets to the secondary market. Season tickets are capped at 22,000 of the 37,000 seats in baseball's smallest park. Buyers can't purchase

Obituary

Theo Albrecht



With his brother, Karl, the reclusive German billionaire built a discount grocery empire and became one of the world's richest men

Theo Albrecht, a billionaire German grocery magnate, noted recluse, and survivor of a bizarre kidnapping, made his mark on the U.S. by operating Trader Joe's, a retail food chain known for the cheerfulness and colorful Hawaiian shirts of its employees. Albrecht's expansion of the no-frills Aldi Group stores made him Germany's third-richest man. He died on July 24 at 88.

Little is known about Albrecht or his 90-year-old brother, Karl, who together presided over a global grocery empire with roots in Germany's industrial Ruhr Valley. Aldi had revenue last year of €53 billion ($69.9 billion). Their success turned the brothers into two of the wealthiest people in the world. Their combined fortune topped $40 billion in 2010, according to *Forbes*.

Theo lived in near-total seclusion, a circumstance compounded after he was kidnapped for a 17-day stretch in 1971. The Albrecht family paid 7 million deutsche marks ($4.6 million at the current rate) in ransom. The money was handed over to the assailants by the bishop of Essen. There are only three confirmed public statements from Theo, according to Klaus Kraenzle, a consumer-goods analyst at GSC Research in Düsseldorf. The last confirmed photograph of either brother appeared in the 1980s, *Der Spiegel* says.

"Aldi mourns a man who was humble toward his business partners as well as fellow employees and always held them in great respect," the company said in a statement. The brothers' key to success was their low-cost business model: a limited assortment of goods that pared down supply expenses and a minimal level of advertising. The result was a shopping experience that lacked the refinement of brightly lit supermarket chains. Consumers often paid less than they would have elsewhere.

Theo was born in the western German city of Essen in 1922. The brothers took over their parents' grocery store in 1946. They opened more outlets, shortening "Albrecht Discount" to Aldi. In 1960 they divided the family food kingdom into two operations: Theo took over the north; Karl, the south. Aldi Nord controls stores in western Europe and Poland, with about 2,400 stores in Germany and 2,000 outside the country. Karl's half, Aldi Süd, has stores in the U.S., U.K., Australia, and elsewhere. Theo purchased Trader Joe's in 1979. The affordably priced chain is known for its lively atmosphere and spirited workers. It has 342 outlets, which generated sales of $8 billion last year.

Aldi Nord's assets are held in protected trusts that will guarantee the company's further expansion, Aldi said in its statement. Theo, who died in Essen, was buried on July 28. The ceremony was private. *—Patrick Donahue and Holger Elfes*

Fortune ▸ The Albrecht brothers' fortune tops $40 billion

Legacy ▸ A global empire with stores in the Europe and the U.S.

Pivotal Life Event ▸ The reclusive mogul was kidnapped for 17 days in 1971

Companies&Industries

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AIRPLANES

Total number ordered, valued at $28 billion, during Britain's Farnborough Air Show in late July. That's three times the number of planes sold at last year's Paris Air Show

more than eight eight passes for a single game, and the club holds back a few hundred tickets for sale on game day.

Still, Red Sox management has resisted the one move that could knock the wind out of the resale market: raising list prices. "The reason there is such a robust secondary market is because we don't price our tickets at the absolute maximum dollar amount," says Chief Operating Officer Sam Kennedy. "Our ownership feels a responsibility to keep tickets as affordable as possible."

There may be other factors that make underpricing easier for management to swallow. For starters, the organization recaptures part of the profit taken by resellers. MLB promotes StubHub, a unit of **eBay**, whose website provides a marketplace for buyers and sellers. Part of StubHub's commissions on MLB tickets flow back to the teams.

In 2007 the Red Sox struck a separate deal with Ace, the only one of its kind in baseball. The arrangement lets the broker use the Red Sox logo and call itself an official partner of the team. Ace agreed to pay an undisclosed sum for promotional space inside Fenway Park. Economist Andrew Zimbalist, a professor at Smith College in Northampton, Mass., says the deal helps the Red Sox preserve the scarcity "buzz" around the streak: "It means when people go to cocktail parties and say they've got tickets, the people listening are jealous."

In effect, the policy helps the team hedge its bets. For the Oct. 1-3 games against the Yankees, Holzman has been buying tickets since before the season started. If the Sox remain in the pennant race, Ace will make a big profit. If the team is out of the playoff chase and the weather turns nasty, demand could collapse—and Holzman could lose millions. "I'm taking some risk off their plate and putting it on mine," he says. *—Christopher Condon*

The bottom line *The Boston Red Sox club has priced tickets in a way that protects the team's sellout streak, shifting risk to resellers.*

Drawing Board



Consumer Products

The British Upstart Challenging P&G

► **Reckitt Benckiser is adding to its medicine chest to spur growth**

► **"It's not technology that drives innovation; it's ideas"**

Bart Becht spent $3.89 billion on condoms and foot care last month. Becht is not a man of unusual proclivities. He's the chief executive officer of **Reckitt Benckiser,** one of Britain's most successful companies. On July 21, he announced the biggest deal of his career: the purchase of **SSL International**, maker of Durex condoms and Scholl foot products. The acquisition is meant to shore up Reckitt's revenue growth, which at 18 percent last year was higher than that of any consumer-products rival.

The Slough (U.K.)-based maker of Clearasil acne cream and French's mustard faces challenges. It has seen a slowdown in Europe, its main market. Its core business in household cleaners is under siege there from **Procter & Gamble**, which has launched detergents and stain removers that directly compete with Reckitt's Finish and Vanish brands. What's more, Suboxone, a heroin-dependency drug that generates 8 percent of Reckitt's sales, may soon have competition in the U.S. from generics. "It's been five or six quarters where Europe is relatively flat, North America is marginally up, and most of the growth is coming out of emerging markets," says Becht. "We do not see that trend changing in the near term."

Still, many executives would count themselves lucky to be in Becht's shoes. With revenues of $12.1 billion in 2009, Reckitt may be a minnow next to P&G. Yet the smaller company's stock has climbed fourfold in the 10 years Becht has been at CEO, vs. 8.9 percent for its American rival. And aside from **Johnson & Johnson**, Reckitt boasts the highest gross margins in the industry, at 60 percent. "Ever since Bart Becht took over in 1999, this has been the best management team in the sector, undisputably," says Dan Dolev, an analyst at Sanford C. Bernstein in New York.

Becht, who ranks as one of the high-

THIS PAGE: ILLUSTRATION BY LARRY WRIGHT/CAGLE CARTOONS. OPPOSITE PAGE: BECHT: CHRIS RATCLIFFE/BLOOMBERG; APPLE: THIBAULT CAMUS/AP PHOTO; MERCK: TONY CENICOLA/THE NEW YORK TIMES/REDUX

est-paid CEOs in the U.K., says Reckitt has thrived in part because of a culture of constructive conflict. "It's not technology that drives innovation; it's ideas," says the 54-year-old Dutchman. "At the end of the day we need to have a fight for better ideas."

Becht recalls the epic fight that one employee waged on behalf of Air Wick Freshmatic, a battery-operated dispenser that sprays air freshener at set intervals. Until five years ago, Reckitt sold the gizmo only in Korea. Then a category manager came up with the idea of adapting it for other markets. Colleagues called the notion "completely nuts," says Becht, as the product had been developed for use in commercial spaces and offices, not homes. Becht backed the manager; today Air Wick Freshmatic is sold in 69 countries and accounts for a fifth of the home-care division's $1.6 billion in annual sales.

Internecine battles can take a toll, Becht concedes. At 15.7 percent, turnover among Reckitt's top 400 international managers exceeded the industry average last year. The company has begun to recruit at universities based on Becht's newfound belief that it is better to promote from within than to hire outsiders. As part of Reckitt's outreach effort to young people, the company's Facebook page features a game presenting players with challenges such as coming up with packaging for the company's Veet line of hair-removal products. Contestants who perform well at each task can eventually work themselves up to company president.



CEO Becht fosters in Reckitt a culture of constructive conflict

Most analysts believe that the Durex and Scholl brands are good fits for Reckitt. For one thing, they will provide greater exposure to Russia and China, two vast consumer markets where the company has a low profile. Says Becht: "The opportunity is geographical rollout but also for innovation in the markets we're already in." Ⓑ

—Sarah Shannon

The bottom line *Reckitt Benckiser's biggest acquisition to date is meant to counter weakness in its household cleaners business.*

In brief

by Cristina Lindblad



An Apple Store in the Louvre in Paris

Apple
The iPhone 4 Gets a Bad Review in France

UFC-Que Choisir, a leading consumer group in France, has joined *Consumer Reports* in deciding not to recommend the iPhone 4 because of problems with the device's antenna. Que Choisir reported on its website on July 27 that the antenna issue outweighs the iPhone's virtues. France is one of the most important markets for Apple, which began selling the new handset outside the U.S. at the end of June. France Telecom is the world's second-largest iPhone carrier after AT&T.

Wal-Mart Stores
The Retailer Is Mulling A Russian Foray

Wal-Mart has hired an executive from BP's Russian oil joint venture to help lead a Moscow office in preparation for possible expansion into the country. Avril Conroy formerly worked in TNK-BP's marketing division. Wal-Mart has no stores in Russia but has hired 30 employees there since 2008. Foreign retailers have been slow to set up shop in the country, with megastores mostly limited to big cities. France's Auchan Group operates about 40 superstores, but compatriot Carrefour announced in October that it was pulling out after less than a year in the country.

IBM
The EU is Launching A Probe of Big Blue

IBM is being investigated by the European Union over claims it abused its dominant position in the market for mainframe computers. The inquiry will look into allegations that IBM improperly linked sales of its hardware to its software for mainframe computers and that it discriminated against competing sellers of services. IBM says Microsoft and its allies are the source of the complaints. The probe signals that Joaquín Almunia, who took on the job of EU Competition Commissioner in February, may share his predecessor's penchant for going after big technology companies. Under Neelie Kroes, the agency extracted billions in penalties from Intel and Microsoft.

Continental
Dispensing with Humans at the Gate

Continental Airlines is testing subway-style boarding gates at its hometown hub in Houston. The gates allow travelers to board planes without the aid of an agent. Barriers on the machines open to let passengers onto the jet bridge after they scan their boarding pass. Continental installed two of the devices at one gate in June. The system could save the airline money—and prevent passengers from jumping the line when their seat hasn't been called.

Reliance Industries
The Indian Energy Producer Is on a Tear

India's biggest company by market value reported its fastest pace of profit growth in more than two years. One reason: a doubling in natural gas production. For the three months ended June 30, net income rose 32.2 percent, to $1.03 billion. The bigger profits should further Chairman Mukesh Ambani's goal of stepping up acquisitions now that he and his brother have scrapped a no-compete agreement.

Merck
Dealing with the Aftermath of Vioxx

Merck has paid claims to the families of 3,468 users of its Vioxx painkiller who died of heart attacks or strokes, a claims administrator told a judge on July 27. The payments were made out of a $4.85 billion settlement fund Merck set up in 2007. U.S. Judge Eldon Fallon in New Orleans, who has overseen Vioxx suits since February 2005, called it "a remarkable achievement." He noted that the parties had "finished the large portion of this litigation."



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Politics&Policy

Nancy Pelosi's Business Brain Trust

▶ **She gets advice and money from West Coast executives**

▶ **The speaker "didn't worry that I was a Republican"**

In two weeks, Nancy Pelosi and her husband, Paul, will host a two-day retreat at a Mediterranean-style inn in Napa Valley, just down the street from the legendary French Laundry restaurant. The guests, as in years past, will include some of her biggest benefactors and some of the most prominent names in corporate California; often they are one and the same.

Financier Bill Hambrecht, who helped **Apple** and **Google** go public, usually attends the annual conference, as do Charles Geschke, the co-founder of **Adobe Systems**, and California commercial real estate developer George Marcus. The retreat is part thank-you, part intellectual gabfest. Last year's theme was the economy; guests were briefed by White House adviser David Axelrod.

Opponents have long called Pelosi "bad for business," but she's not the anti-business ideologue of the typical Republican caricature. She regularly seeks out corporate leaders for their take on the economy and talks frequently with Bay Area business titans like Google CEO Eric Schmidt. Her brain trust includes numerous chief executives and venture capitalists. "I have found her to be supportive of Silicon Valley and the entire technology industry and always open to a healthy give-and-take on key issues," says **Cisco Systems** CEO John Chambers, who helped Pelosi develop an innovation agenda in 2005 that included a permanent R&D tax credit, education funding, and universal broadband access.

Opponents claim Pelosi heaps regulations on existing industries and costs the economy jobs

Many of these unofficial advisers are her biggest donors, and the policies she advocates often benefit their industries. To hear Pelosi, 70, tell it, she's sowing the seeds of an economic revival that wouldn't be possible without a big nudge from the government. Her state's high-tech and clean-energy industries could benefit from that push, as could the rest of America, she argues. "We don't have any choice. We have to compete," Pelosi said in a July 14 interview with *Bloomberg Businessweek*. "These other countries have made their decision," she said, referring to China and Europe, where governments have plowed billions into renewable fuels like wind and solar. "We had an Industrial Revolution, we had the Technological Revolution, and the Green Revolution," Pelosi said. "Are we going to check out of this? I don't think so."

Pelosi supports higher taxes for the wealthy and government competition in health care to lower costs to consumers. She tried and failed to charge financial firms for the Wall Street overhaul. These positions have made her a favorite target of Republicans, who say she costs the economy jobs. They argue that she picks winners and losers by heaping new regulations on existing industries while setting aside taxpayer funds for chosen sectors such as renewable energy and biotech. "Her agenda has added 500,000 government jobs and lost 2.5 million free-enterprise-sector jobs," says Representative Pete Sessions (R-Tex.), who chairs the House Republicans' campaign committee.

Judging by the legislation she's gotten through with few, if any, Republican votes, Pelosi has had much success as a speaker. Some Demo-



Bill Hambrecht, Chairman, W.R. Hambrecht

The legendary investor, who helped bring Google and Apple public, credits Pelosi for getting him involved in politics. He has given Pelosi and the Democratic Congressional Campaign Committee $159,500 since 1997



John Doerr, Partner, Kleiner Perkins Caufield & Byers

Venture capitalist Doerr is an idea machine for Pelosi's office, keeping her abreast of emerging industries and business trends in Silicon Valley. He is not a donor.



Robert Haas, Former chairman and CEO, Levi Strauss

Haas is an heir to the Levi Strauss fortune, a close Pelosi friend, and frequent adviser. The Speaker also has ties to other Levi Strauss heirs. Haas has given her $14,700 since 2001.



John Chambers, Chairman and CEO, Cisco Systems

He has been the speaker's sounding board over the decade-plus he's known her. A generous contributor to Republicans and a few Democrats, Chambers is not a Pelosi donor.



Eric Schmidt, Chairman and CEO, Google

The keynote speaker at the House Democrats' retreat this year, Schmidt has given Pelosi and the DCCC $32,000 since 2001.



Bill Gates, founder and Chairman, Microsoft

Pelosi and other House Democrats speak to Gates a few times a year about innovation, the Gates Foundation, and other issues. Gates has given Pelosi $3,000 since 2007.

Millard "Mickey" Drexler, Chairman and CEO, J. Crew Group

The man behind the apparel chain's resurgence, and former head of San Francisco-based The Gap, talks with the Speaker about consumer trends in the economy. Has given Pelosi and the DCCC $187,650 since 1990.





The House Speaker relies on a brain trust of venture capitalists, high-tech entrepreneurs, financiers, developers, and corporate heirs for money and advice.

John W. Thompson, Chairman, Symantec

Pelosi named Thompson, the only African-American to lead a major tech company, to the Financial Crisis Inquiry Commission. He has given more than $50,000 to the DCCC since 2002.





Tom Steyer, Managing director, private equity firm Hellman & Friedman, founder of hedge fund Farallon Capital Management

He keeps Pelosi abreast of market developments. Steyer has given her and the DCCC $107,100 since 1997.



George Marcus, Founder, Essex Property Trust and Marcus & Millichap

Of a long list of California real-estate developers with Pelosi ties, he is closest to the speaker. He's given her and House Democrats $164,700 since '97.

Vinod Khosla, Founder, Khosla Ventures

A Republican, co-founder of Sun Microsystems, and prominent Silicon Valley VC, Khosla is a major Pelosi donor since making the environment his top political and business priority. He and his wife have given the Speaker $168,720 since 2005.



Charles Geschke, Co-founder, Adobe Systems

A personal friend and major financial backer for House Democrats, Geschke has given Pelosi and the DCCC $243,950 since 1997.



Graphic by The Department for Information Design at Copenhagen

crats facing tough reelection contests in November say she is, perhaps, too successful. Last year, when vulnerable members balked at voting to cap carbon emissions, she and the Administration said Senate Democrats would follow the House's lead, allowing lawmakers to boast they had slowed global warming and reduced dependence on foreign oil. The Senate never voted, and some House Democrats are unhappy that they must defend a vote that their GOP challengers say would have raised homeowners' energy bills.

If you listen to her long enough, Pelosi begins to sound like the venture capitalists in her circle, which includes Silicon Valley pioneers such as Hambrecht and John Doerr of **Kleiner Perkins Caufield & Byers**. He and Cisco's Chambers are not among her donors.

There are even some Republicans in her network. Vinod Khosla, the cofounder of **Sun Microsystems**, says she invited him to breakfast in 2005 after both spoke at a forum in Fremont, Calif. She wanted to pick his brain about renewable energy and innovation. "She didn't worry that I was a Republican," Khosla says. "She is very open-minded. That impressed me." The two have been close since.

Such relationships have an obvious benefit for Pelosi, who raises millions from her corporate confidants. In the years since Khosla first had breakfast with Pelosi, he and his wife have given her and the Democratic Congressional Campaign Committee nearly $170,000. Her donors' companies often benefit from Pelosi's advocacy for research tax credits, visas for engineers, and government funding for clean-energy startups. **Stion**, a maker of thin photovoltaic solar cells and backed by Khosla, received $37.5 million in tax credits through last year's economic stimulus measure.

Pelosi is not shy about asking the tech community for help in return. "They want H-1B visas for immigration, and we're saying 'help us have a comprehensive immigration reform and we can help you with that,'" Pelosi said in the interview. "But we've got to do things together." *—Patrick O'Connor and James Rowley, with Rochelle Garner*

The bottom line *Pelosi, called anti-business by Republicans, receives advice and campaign cash from numerous California executives.*



Warren is a contender to head a new consumer agency

Regulation

A Would-Be Watchdog Woos the Opposition

- **Elizabeth Warren reaches out to lobbyists and Republicans**
- **"I don't think it's a fight Obama wants if he doesn't think he can win"**

Liberal activists who want Harvard law professor Elizabeth Warren to lead the new consumer financial protection bureau have been winning support from lawmakers, bloggers, and editorial pages. Success may ultimately depend on whether a quieter campaign can win over detractors. In the past year she has dined with bank lobbyists, explained the new financial regulation law to analysts, and met privately with Republican senators, including Susan M. Collins of Maine and Bob Corker of Tennessee.

If President Barack Obama nominates Warren, the relationships she has been building could blunt a confirmation battle by countering criticism that her consumer crusading would make it hard to negotiate fairly with business groups. Warren's fight for the consumer agency's creation alienated many on Wall Street and elsewhere, even as she made overtures to industry. "It's perfectly natural that she would reach out to different industry groups and see what makes them tick," says Camden R. Fine, president of Independent Community Bankers, who has met with Warren half a dozen times in the last year, including for lunch at a Capitol Hill restaurant last month.

White House officials have said that Warren, 61, chairman of a panel overseeing the Troubled Asset Relief Program, is on Obama's short list, even though Senate Banking Chairman Chris Dodd has questioned whether she could muster 60 Senate votes for confirmation. Also on the list are Assistant Treasury Secretary Michael Barr and Gene Kimmelman, a former Consumers Union director who is chief counsel for competition policy at the Justice Dept.

More recently, others have mentioned the possibility that Obama might name Sheila Bair, chairman of the Federal Deposit Insurance Corp. She has

PREVIOUS SPREAD: PELOSI: ETHAN MILLER/GETTY IMAGES; CLOCKWISE FROM TOP: ANDREW HARRER/BLOOMBERG; JASON ALDEN/BLOOMBERG; JIN LEE/BLOOMBERG/GETTY IMAGES; JOCHEN SIEGLE/POLARIS; NO CREDIT; MATTHEW STAVER/BLOOMBERG; GARY FABIANO/SIPA PRESS; KIM WHITE/BLOOMBERG; FIORITO PHOTO/EVELYN AND WALTER HAAS JR. FUND/ BLOOMBERG; ROGER L. WOLLENBERG/UPI/LANDOV; STEVEN BRAHMS/BLOOMBERG; PETER DASILVA/THE NEW YORK TIMES/REDUX

strong bipartisan support on Capitol Hill and has run a large agency. Warren, however, has been the most visible: When Obama signed the regulatory overhaul law on July 21, she sat in the front row before joining White House Senior Advisor Valerie Jarrett for lunch.

As he mulls whether to nominate Warren, Obama must calculate the political cost of a confirmation battle in a difficult election year for Democrats, as well as his tattered relationship with business. "I don't think it's a fight Obama wants to wage if he doesn't think he can win it," says Mark A. Calabria, director of financial regulation studies at the Cato Institute, a free-market think tank in Washington.

Asked about Warren's candidacy, White House spokesmen pointed to earlier statements defending her qualifications. And business lobbying groups wouldn't talk about her possible nomination. "We're not commenting on any appointees right now," says Elise Brooks, spokeswoman for the Financial Services Roundtable. Warren, too, declined to comment.

Obama must decide whether she has the management skill to unite parts of seven agencies to create a bureau with more than 1,000 employees, a $400 million budget, and the power to impose rules on mortgages, credit cards, and even layaway plans. "The first director will set the direction and tone for the agency for decades," says Travis Plunkett, legislative director at the Consumer Federation. "Look at Joe Kennedy and the SEC in the 1930s. He established that agency as a vigorous Wall Street overseer," says Plunkett, referring to the Securities & Exchange Commission.

Not everyone on Wall Street is against her. Mike Mayo, an analyst with Crédit Agricole Securities (USA), wrote in a May 7 note to investors that Warren, in a conference call with investors, had made "the best argument that we have heard yet" for a consumer agency.

Still, many of her Republican opponents remain steadfast. "I would not support her for that job," says Senator Richard Shelby of Alabama. "She would have no real check on her, only her imagination." —*Lorraine Woellert and Alison Vekshin*

The bottom line *Elizabeth Warren's industry outreach could smooth the way for Obama to name her as head of a new consumer financial protection bureau.*

OPPOSITE PAGE: NIGEL PARRY/CPI SYNDICATION; THIS PAGE, FROM TOP: LOUIS LANZANO/AP PHOTO; JASON REED/REUTERS

Investigations

Whistleblowers Get a Raise

- The SEC will offer up to 30 percent of the money from fines
- The volume of leads "is going to go up exponentially"

In the 21 years since the Securities & Exchange Commission introduced rewards for insider-trading tipsters, the agency has disbursed just $1.16 million to six claimants, including a $1 million payout earlier this month to a woman who blew the whistle on the founder of the hedge fund **Pequot Capital Management**. With the financial-regulation overhaul signed into law by President Barack Obama on July 21, that stately pace is expected to accelerate dramatically.

Stung by accusations that it ignored reports of Bernard Madoff's misdeeds, the commission asked Congress to increase bounties and expand the SEC's authority to reward tipsters for leads on other types of misconduct, including Ponzi schemes and accounting frauds. Those wishes were answered: The financial overhaul says the agency can make whistleblower awards in any case that triggers a sanction exceeding $1 million. And tipsters are now entitled to as much as 30 percent of all the money the SEC collects, including fines and ill-gotten profits. In the past, claimants were eligible for only a 10 percent share of any fine. "The whistleblower provision will substantially benefit our enforcement program by encouraging those with evidence of fraud to come forward," says SEC spokesman John Nester.

What it won't ensure is that the SEC has the resources or expertise to uncover frauds better than it has in the past, particularly as the regulator braces for a flood of whistleblowers attracted by more lucrative bounties. To prepare, the SEC has hired consultants and is studying successful tipster programs at the IRS and Justice Dept. The agency also is using increased funding from Congress to acquire technology that will make it easier for investigators to sort through reams of information on companies accused of wrongdoing. The SEC says its computer system will be upgraded by the end of the year. "They already get a lot of tips, and the number is going to go up exponentially," says Daniel J. Hurson, a former SEC attorney now in private practice in Washington. "They are going to have to have a good system in place to separate the wheat from the chaff."

The goal is to avoid a repeat of past enforcement failures. In 2005, whistleblower Harry Markopolos gave investigators a 21-page report about Madoff titled "The World's Largest Hedge Fund Is a Fraud." Even with that road map, the SEC fumbled the investigation. The $65 billion Ponzi scheme wasn't exposed until December 2008, when Madoff couldn't meet his investors' withdrawal requests.

Some critics warn that the additional powers granted by Congress may create a new set of problems for the agency. One unintended consequence, says former SEC Commissioner Paul S. Atkins, is that disgruntled corporate employees now have more incentive





Warnings from Markopolos (left) about Madoff went unheeded

to lodge complaints, which will lead to higher legal fees for companies that have to respond to investigations. The flood of tips may also divert the SEC's limited resources away from legitimate cases, Atkins says. —*Jesse Westbrook*

The bottom line *Larger rewards for whistleblowers could bury the SEC in thousands of additional tips alleging wrongdoing.*

Energy

CleanTech's Comedown In the Senate

- ▶ Startups say it's hard to compete unless carbon prices rise
- ▶ "If we had this climate bill passed, the money would flow immediately"


Harry Reid is scaling back the Senate's green energy ambitions

Jack Oswald, the chief executive officer of biofuel company **SynGest**, had plans to build at least 15 new plants to turn corncobs into nitrogen fertilizer. Now that Democrats have pulled the plug on climate-change legislation, he says he may be able to attract investors for only five.

Senate Majority Leader Harry Reid, facing Republican resistance to measures that might increase household energy costs, on July 28 said he would push scaled-back legislation that provides energy conservation incentives and removes the liability cap for offshore oil leaks. Encouraged by the White House, clean-energy advocates like Oswald had expected that Congress would also pass a bill putting a limit on carbon and authorizing the trading of emission permits. The trading system would have the effect of generating higher prices for carbon, making clean-energy companies more competitive, and producing "green-collar" jobs, according to its backers.

The House passed climate-change legislation in June 2009, and as recently as last month White House Chief of Staff Rahm Emanuel said he believed the Administration could get a bill through the Senate. Reid's announcement dashed those hopes for this year, and possibly beyond, especially if Republicans reduce or end the Democrats' majorities in November. "If we had this climate bill passed, the money would flow immediately," Oswald says. "This is the biggest economic opportunity we have in front of our country, and for some reason our politicians can't get their minds wrapped around it."

Fertilizer is now made with natural gas, a process that releases more heat-trapping carbon into the atmosphere than using corn-based products. If carbon trading commenced, the ability to price those emissions could take away some of the cost advantage of gas. That would enable SynGest to attract financial backing for a "rolling thunder of construction" across the Midwest, Oswald says. Each SynGest plant would create 360 temporary construction jobs, 40 permanent ones, and a local market for corncobs of as much as $10 million, he says.

Putting a price on carbon is "huge" because it would fairly account for the environmental costs of greenhouse gas emissions, says Sunil Paul of **Spring Ventures**, an investment fund that specializes in clean-tech companies. Accounting for both capital and operating expenses, coal costs an average of $59 a megawatt hour, according to Milo

Quoted

"It would be foolish to dramatically reduce the deficit immediately."
—Peter Orszag, warning against choking off the recovery in his last speech as President Barack Obama's budget director on July 28 at the Brookings Institution



FROM LEFT TO RIGHT: ANDREW HARRER/BLOOMBERG; PETE MAROVICH/ZUMA PRESS; MOVIESTORE COLLECTION LTD/ALAMY



Disney's digital mouse house page 35 ▶



Sjardin, an analyst at Bloomberg New Energy Finance. Onshore wind costs an average of $91 per megawatt hour. If carbon costs $20 per ton in a trading market, as analysts have estimated, the price of coal would increase by $14 a megawatt hour, according to Sjardin, who says the cost difference would close as carbon prices inevitably rise.

In a cruel twist for supporters of cap-and-trade, the Gulf oil spill may have contributed to the bill's undoing. Incentives for more offshore drilling were part of a compromise that Senator Lindsey Graham (R-S.C.) added in exchange for a carbon cap. Once the incentives were stripped out in response to BP's Gulf disaster, all hope of Republican backing evaporated.

The bill's travails have already hurt renewable energy companies. Additions of wind power in the U.S. in the first six months of 2010 sank 70 percent from a year earlier and lagged new coal plants for the first time in three years, according to the American Wind Energy Assn., a trade group. Lewis Hay, CEO of **NextEra Energy**, the largest U.S. producer of wind and solar energy, says that without a price on carbon and a mandate that utilities buy at least some renewable energy, his company won't invest an additional $2 billion a year in wind, as it had planned to do. —*Jim Snyder and Kim Chipman*

The bottom line *The Senate's inaction on climate-change legislation means renewable-energy companies will have trouble competing.*

Small Business

No Lobbying Help for The Little Guys

▶ Trade groups are silent on a $30 billion fund to spur lending

▶ They "lose interest when the money goes to small businesses"

In 2008, three of the best-known business trade groups in Washington blitzed Congress to approve a $700 billion bailout for Wall Street. Two years later, those groups—the U.S. Chamber of Commerce, the National Federation of Independent Business, and the National Association of Manufacturers—are missing in action as the smaller companies that account for the majority of their membership seek a $30 billion rescue of their own.

The silence is leaving car-parts makers, franchise owners, and community bankers to fend for themselves in pushing for a small business lending fund, which has languished in Congress since President Barack Obama proposed it late last year. The Senate could vote on the fund as early as July 29. The hands-off approach reflects the public backlash against government spending, particularly the Treasury's Troubled Asset Relief Program, which rescued the country's biggest banks but sparked populist ire. Federal spending has become a flash point in many of this fall's congressional races.

The measure would ease terms for loans guaranteed by the Small Business Administration, provide $12 billion in tax breaks, and issue grants to states for business loans. While lawmakers in both parties—and the business lobbies—lauded those provisions, most Republicans balked at a related $30 billion fund that would be used to encourage community banks to lend to small businesses. "This is as American as apple pie," Obama said of the bill on July 28, as he met with small business owners at a Tastee Sub Shop in Edison, N.J.

Supporters say community banks, which would be able to borrow from the fund at low rates, could leverage the $30 billion into $300 billion in loans, providing added stimulus to the economy. "Businesses that have enjoyed years of profits and expansion have had loan requests rejected and credit limits restricted," Christopher J. Kersting, president of the Specialty Equipment Market Assn., wrote in a letter to members of Congress.

Some critics fear the community-bank fund could induce smaller lenders to make imprudent loans. Lending data show that small business borrowers have defaulted at a far higher rate than big businesses have. At JPMorgan Chase, for example, second-quarter charge-offs were 4.04 percent for small businesses vs. 0.74 percent for all commercial loans. The way the fund's backers see it, "everyone's a good borrower, and that's just not the case," says Eliot Stark, managing director at Capital Insight Partners in Chicago.

$300 BILLION

Amount of small business loans a new fund might create

The major business groups, which together spent more than $47 million to lobby for tax cuts and against the Administration's health-care overhaul in the first six months of this year, haven't been moved by arguments such as Kersting's. The silence "certainly is peculiar," says Frank Knapp Jr., president of the South Carolina Small Business Chamber of Commerce, which is critical of the U.S. Chamber. "But it's not unusual that they lose interest when the money is going to community banks and small businesses." —*Mark Drajem, Laura Keeley, and David Henry*

The bottom line *Trade groups that lobbied for the big bank bailout aren't backing a $30 billion fund that could stimulate small business lending.*

Approved riding area.

"IF IT WAS SIMPLY ABOUT MONEY,

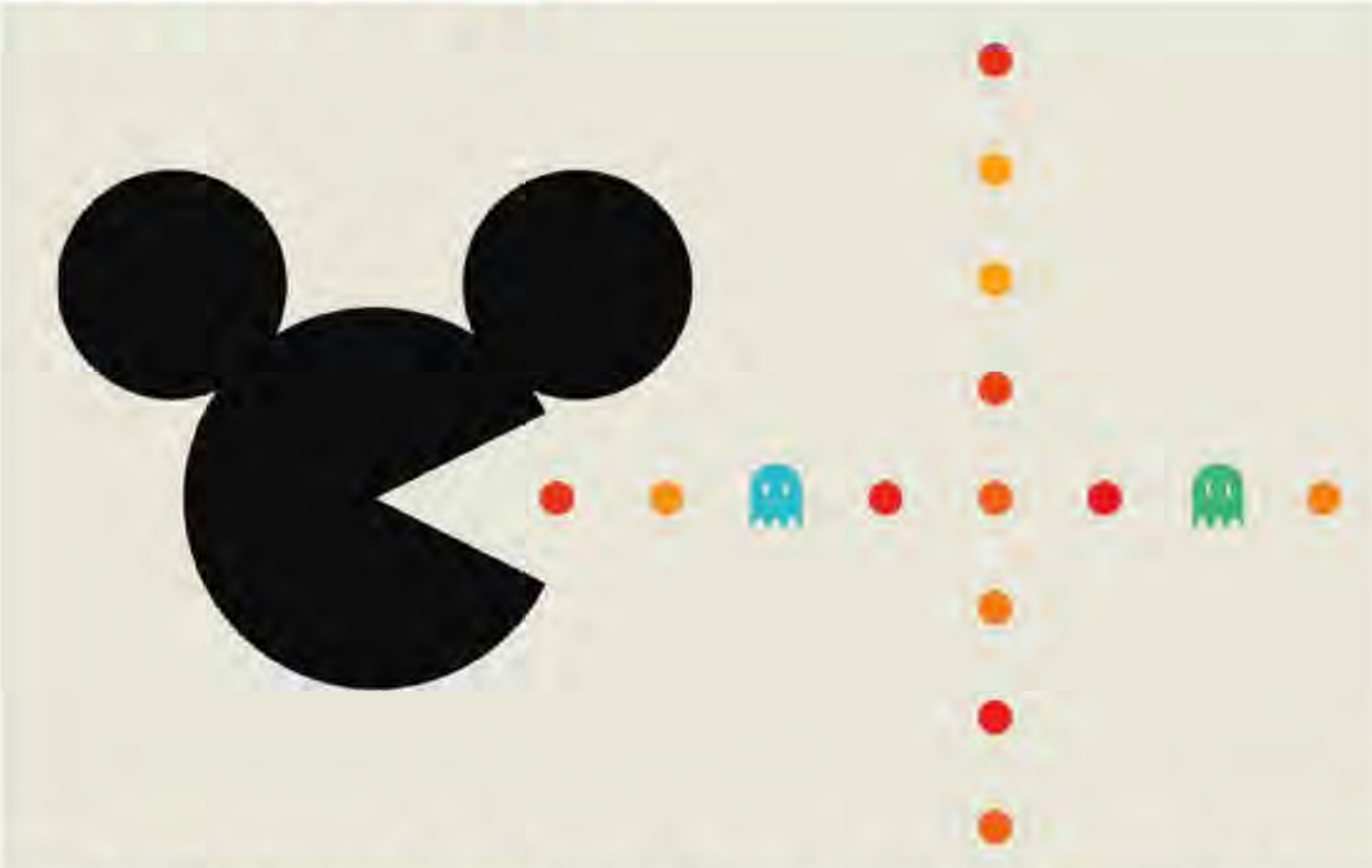
EVERY BANK LOAN WOULD BE A GUARANTEE OF SUCCESS.

At GE Capital, loaning money is the start of the relationship. Not the end. We provide exclusive financing for 1,400 independent Polaris dealers across the country. Providing financing means providing life to these dealers. But it has to be about more than money. We're out there helping Polaris identify new markets, go deeper into existing ones. I've been working with Polaris for 26 years. It's pretty simple math – GE Capital succeeds only if Polaris succeeds. Course, it also helps that I love to ride!"

GE Capital is invested in Polaris.



Technology



The Logic Behind Disney's Digital Shopping Spree

▸ **The purchase of game maker Playdom may help Disney's brands with the Facebook generation**

▸ **"It's the right strategy for Disney to buy, and they are looking at some very savvy acquisitions"**

Four years ago, Bob Iger, the chief executive officer of **Walt Disney**, tried to build a cell-phone business. Disney created a family-oriented mobile service that included a global positioning system so parents could track their kids. Too few consumers signed up, and the company killed the operation after 15 months. Disney Interactive, the division that ran the ill-fated cell service, is still unprofitable. It lost $55 million last quarter.

Iger retains his enthusiasm for digital business and has switched strategies to buying rather than building. He wants to acquire social games and other online services that come with established customers and talented creators—and can help sell Disney's famous brands. "You don't get the kind of growth we want by building from the inside," he says.

Since paying $350 million for the kids' social network Club Penguin three years ago, Disney has purchased Wideload Games, whose founder helped create **Microsoft**'s hit Halo franchise. Early last month, the entertainment giant acquired

"I don't think they're looking for Playdom's revenues as much as they're looking for Playdom's knowhow"

Tapulous, a publisher of music-related games for **Apple**'s iPhone. On July 27, Disney made its biggest video game bet yet, agreeing to pay $563 million for privately held **Playdom**, the Mountain View (Calif.) maker of Sorority Life and Mobsters, which are played on **Facebook**, MySpace, and mobile phones. If Playdom meets performance targets over time, its founders and investors may receive an additional $200 million.

Playdom specializes in games that sell virtual goods. In Mobsters, players try to build crime syndicates by buying—with real money—digital machine guns and henchmen. In Sorority Life, players buy clothing and

ILLUSTRATION BY GREG MABLY

accessories as they climb a social ladder. Some 42 million people regularly play Playdom's games each month, according to Disney. Analyst Michael Pachter of Wedbush Morgan Securities says the purchase of Playdom will give Disney a potentially fast-growing venue to sell every Disney character and media brand from Mickey Mouse to Spider-Man to ESPN.

For example, when Disney releases the Pixar movie *Cars 2* next June, it could promote the film by using its soundtrack in a Tapulous-made music game for mobile phones and weaving *Cars 2* characters into Playdom games on Facebook. Disney plans to launch a virtual world based on *Cars* this month. That would be in addition to more traditional product tie-ins–plush-toy merchandise, games for Nintendo's Wii console, coverage on ABC and the Disney Channel, and theme park rides.

"I don't think they're looking for Playdom's revenues as much as they're looking for Playdom's knowhow" in working social games into the Disney mix, Pachter says. Playdom CEO John Pleasants is moving to Disney, where he will continue to oversee social game development and become an executive vice-president. He'll be working with Iger's point man for digital strategy, Steve Wadsworth, who has run Disney's Internet unit since 1999 and assumed video game oversight in 2008.

Iger says the buy-don't-build approach is what drove some earlier acquisitions. His $8.1 billion purchase of Pixar in 2006, for example, buttressed Disney's flagging animation division; the $4.2 billion acquisition of Marvel Entertainment last year gave the company iconic comic-book characters that appeal to boys. (Disney had been known more for cartoon princesses than superheroes.) Club Penguin was the company's first acquisition of a virtual world. The site's founders are busy running online worlds with monthly subscription fees and sales of virtual goods; they built the Cars site that will launch this month and are overseeing older ones like Pirates of the Caribbean Online.

Iger has some Internet talent on his board to lean on as he makes digital deals. Apple CEO Steve Jobs joined as a result of the Pixar acquisition and is Disney's largest shareholder. Disney was the first to sell TV shows and films on Apple's iTunes online media store. In March, Iger tapped Facebook Chief Operating Officer Sheryl Sandberg to become a director. Since then Disney has increased its presence on the social network and experimented with using it to sell tickets to the Pixar movie *Toy Story 3*.

It's been typical for big media companies to lose money online. **News Corp.**'s digital media unit lost $150 million in the quarter ended in March. **CBS** stopped breaking out results for interactive after that unit lost $41.3 million during the first nine months of 2009.

Could Disney's acquisitions put it on track to make some money online? "It's the right strategy for Disney to buy," says Gina Bianchini, a venture capitalist who co-founded the social network Ning.com with Marc Andreessen. "And they are looking at some very savvy acquisitions." —*Andy Fixmer and Ronald Grover, with Douglas MacMillan*

The bottom line *Disney's Iger attempts to buy his way to digital success with the purchase of game maker Playdom.*

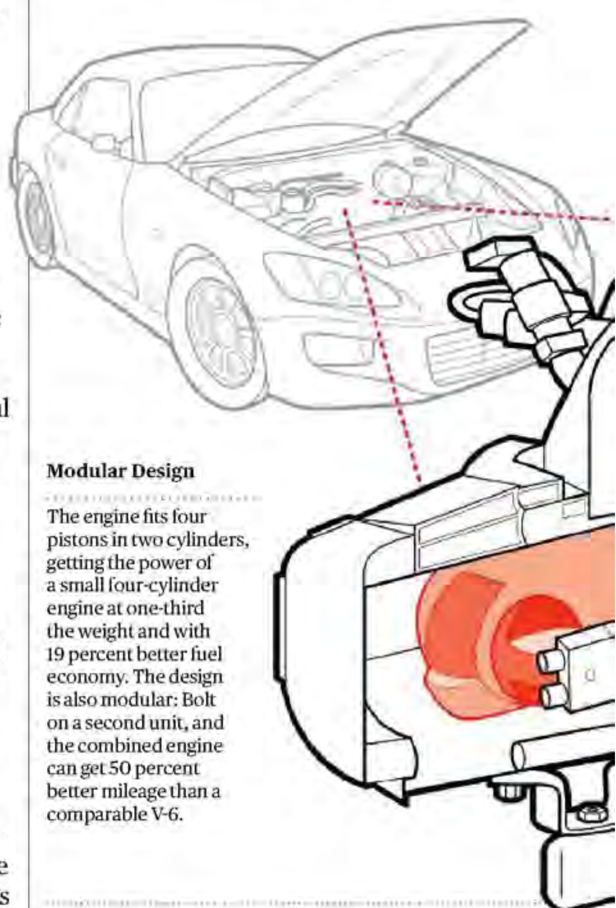


Number of respondents who said they would be willing to pay to use Twitter, out of 1,981 surveyed by the University of Southern California

DATA: USC ANNENBERG SCHOOL

The Opposed-Piston Engine

EcoMotors says its design packs more power, using less gas than regular engines



Modular Design

The engine fits four pistons in two cylinders, getting the power of a small four-cylinder engine at one-third the weight and with 19 percent better fuel economy. The design is also modular: Bolt on a second unit, and the combined engine can get 50 percent better mileage than a comparable V-6.

Automobiles

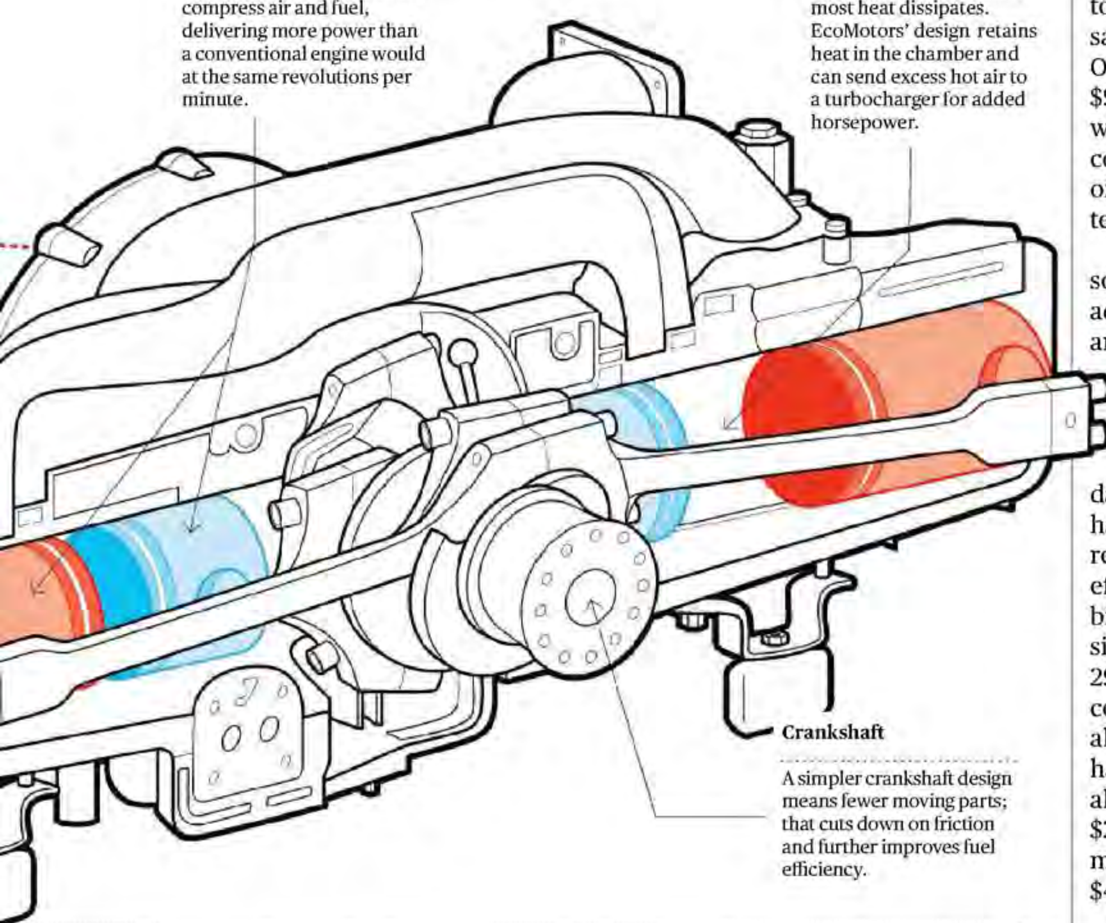
The Combustion Engine Gets Downsized

- **EcoMotors promises 50 percent better mileage at a low cost**
- **With new technology, "you look for the Achilles' heel"**

Retired **Ford** engineer John Coletti got a call in 2007 from Vinod Khosla, the Silicon Valley venture capitalist. Khosla, co-founder of **Sun Microsystems**, wanted advice on a new engine technology in which he was considering investing. A mutual friend suggested he contact Coletti, who had served as the chief of Ford's performance division. Coletti was skeptical that the design in question could deliver a promised 50 percent improvement in fuel economy. "Any time you hear about a new engine



Greek villas going cheap page 44 ▶



technology, you look for the Achilles' heel," the engineer said.

He pored over the **EcoMotors International** opposed-piston, opposed-cylinder (OPOC) engine. To his surprise, he concluded that it could perform as advertised. Coletti joined the company as president and chief operating officer in February 2008. Khosla and **Microsoft** founder Bill Gates were impressed, too, and together have invested $34 million in EcoMotors. They are attracted by a motor that, in theory, would allow a large pickup to achieve 27 miles per gallon. The company plans to license the technology to carmakers that would make their own OPOC engines, or manufacture and sell the engines through joint ventures.

Traditional engines have one piston per cylinder; EcoMotors' version has two. The design saves space and weight, allowing for a 95-pound engine that is one-third the heft of a small, conventional four-cylinder motor and 15 percent to 19 percent more efficient. Designed by Peter Hofbauer, a former **Volkswagen** engineer and founder of EcoMotors, the small, modular engines can be hooked together to power autos of different sizes. A pair would yield a 150-horsepower motor suitable for a midsize car like a **Toyota** Camry. When the car is coasting, one of the engines shuts down, delivering a 50 percent boost in fuel economy. That's a similar efficiency gain to what a hybrid gets, only EcoMotors says its model is less expensive. An OPOC engine will add roughly $600 to $900 to the cost of a vehicle, compared with an extra $3,000 for a hybrid, according to Don Runkle, chief executive officer of EcoMotors. Says Coletti: "This technology is disruptive to the industry."

The question is whether it will be so disruptive that manufacturers won't adopt it. The OPOC engine's flat, rectangular shape is different from that of traditional motors, which typically have vertical pistons in a taller, square block. The EcoMotors pistons are horizontal. To accommodate an OPOC engine, carmakers would have to overhaul assembly lines and redesign models. That would be a huge effort for automakers that already have billions tied up in current engine designs, says James N. Hall, principal of 2953 Analytics, a Birmingham (Mich.) consulting firm. "Engine plans are usually 10 years out," Hall adds. "They'll have to find someone who is willing to alter their plan." Coletti says that it takes $280 million to retrofit a factory and make it OPOC-ready, compared with $400 million to build a new plant.

Khosla emphasizes that EcoMotors has potential outside the U.S. **Zhongding Holding**, a Chinese auto-parts maker, has tentatively agreed to invest $18 million in the technology and has plans to build diesel and gasoline versions. In India, Khosla says, the hot car is a $2,500 **Tata** Nano subcompact. Increasing efficiency by adding hybrid-electric hardware could double the price the manufacturer can charge and put it out of the reach of most consumers. The EcoMotors design would be more cost-effective. "A lot of technologies have a 10- to 20-year payback," Khosla says. "This has a payback in the first year."

Runkle acknowledges, though, that it could be a couple of years before the engine is running in a saleable car. Finding early adopters will be critical. "Somebody will be very aggressive," he says. "I don't know who it is yet, but somebody will be."

—*David Welch and Mark Clothier*

The bottom line *Backed by Vinod Khosla and Bill Gates, EcoMotors plans a new engine that may appeal to automakers in India and China.*

Quoted

"I understand that advertising supports the Internet, but I am a little spooked out. This is creepy."
—Senator Claire McCaskill (D-Mo.) on the ways marketers target people based on their Web surfing habits



ILLUSTRATION BY KATE FRANCIS; MCCASKILL: ALEX WONG/GETTY IMAGES

Technology

A BBW50 Update

Amazon Doubles Down On the Kindle

- ▶ The Web retailer releases two new versions of its popular e-reader
- ▶ “People will buy multiple units for their households”

When Apple released the iPad in April, obituaries for Amazon’s Kindle e-reader proliferated. “Consumer interest in the Kindle will fade into oblivion,” wrote ZDNet columnist Jason Perlow. Instead of planning a funeral, Amazon, a Bloomberg Businessweek 50 company, is betting on growth for its hit product and placing it at the center of its digital media strategy. The company announced on July 19 that Kindle sales had accelerated every month since the iPad’s debut. At press time, the e-tailing giant was planning to introduce two new versions of the device on July 29.

“This is the third generation of the Kindle,” says Chief Executive Officer Jeff Bezos at Amazon’s new campus on the Seattle waterfront. “There’s going to be a generation 10 and a generation 20.” Bezos says low-cost e-readers will find buyers in a market increasingly crowded by more versatile tablet computers. “We’re trying to build something that’s great for long-form reading–something you’d use if you want to sit down and read for two hours,” he says. “We think that’s a mass product.”

The new Kindles are thinner and lighter than previous versions and feature faster page turns, sharper resolution, improved visibility for reading in sunlight–Bezos carries one to a bright window to demonstrate–and batteries that will last for a month on a single

Bezos says he’s in no hurry to add color and touchscreens to the Kindle





charge. One version, Amazon's cheapest yet, will sell for $139 and work in Wi-Fi zones only. "We think at that price point people will buy multiple units for their households," Bezos says. The other model will cost $189 and also work over a cellular network. Amazon dropped the price of the Kindle from $259 to $189 in June. Research firm Susquehanna Financial Group estimates that Amazon has sold 3 million Kindles since their release in November 2007. (Amazon does not disclose sales numbers.) Apple has sold 3.27 million iPads since April at prices from $499 to $829, depending on memory capacity and network service.

At Amazon, e-Books have already overtaken hardcover sales, and Bezos predicts they will eclipse paperbacks in 9 to 12 months. The question for Amazon is whether consumers will prefer to read digital content on devices that aren't Kindles. Bill Hill, who led Microsoft's research on onscreen reading for 15 years, says the Kindle "proved that e-books were practical." Still, he predicts, the devices will likely fade in the era of tablets. "You want to be able to read Web content as well. You'd like to have your magazines and newspapers delivered that way, with color pictures and video."

According to Hill, the Kindle's battery-sipping E Ink technology, which mimics paper books by displaying text in black-and-white without any backlighting, is fast approaching its physical limits: "Otherwise we would have seen color devices a long time ago." Amazon is testing color displays at its lab in Cupertino, Calif., a mile from Apple's headquarters. Bezos says the technology is "not ready for prime time." He says he's not convinced that the Kindle needs color or a touchscreen. "There are a number of technologies out there, and to varying degrees we've examined all of them," he says. "We want a display technology that does not compromise long-form reading." A color screen, he argues, doesn't make an Ernest Hemingway novel any better. Touchscreens are subject to glare. Plowing through a 300-page book on the iPad's LCD screen feels like "reading with a flashlight shining in your eyes," Bezos claims.

It may not matter whether the Amazon CEO has guessed right about consumer preferences. While the Kindle is his company's best-selling product, the device accounts for a small slice of overall revenue. According to research firm Caris & Co., Kindle hardware sales will be 3.3 percent of total revenue this year, or $1.1 billion. Amazon has hedged its bets by making e-books available across a variety of devices, including iPads and smartphones that run Google's Android operating system. "The real task," says Dmitriy Molchanov, an analyst at Yankee Group, "is converting people from physical media to digital media. Any device that can do that will help [Amazon]."

—Joseph Galante and Ira Boudway

The bottom line *Even if the Kindle fades as people buy tablet PCs, Amazon has hedged its bets by making its e-books available on a wide variety of devices.*

JOE PUGLIESE/CORBIS OUTLINE



Technology

Software

Fits and Starts for Startup Flipboard

- ▶ The iPad app maker has big traffic its first week—and big headaches
- ▶ "Our servers were getting completely inundated"

What's it like to be one of the hottest startups in Silicon Valley? Last month, Flipboard found out. The Palo Alto (Calif.) company makes a free application for Apple's iPad tablet that it calls a "social magazine." The app automatically pulls in articles, photos, and video from online publications you select—or that your friends link to on Twitter and Facebook—and presents them in a format resembling a printed magazine.

The team rang a gong to celebrate its launch at 9 p.m. on Tuesday, July 20. Glowing reviews poured in from around the world. Technology blogger Robert Scoble called it "remarkable." Actor (and Flipboard investor) Ashton Kutcher touted the app to his 5.3 million Twitter followers. It became the top iPad download. Venture capitalist John Doerr, whose firm is also an investor, took a celebratory photo of the team.

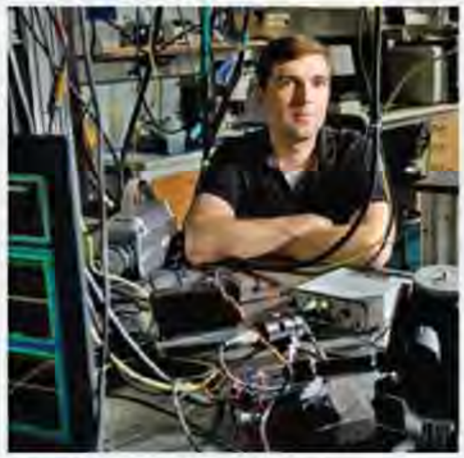
Trouble began that very night. "Our servers were getting completely inundated," says Chief Executive Officer Mike McCue. The traffic jam rendered the app useless for many who had downloaded it. Frustrated users vented on Twitter and left one-star reviews. "Don't waste your time," wrote one iTunes user identified as GeekZoom. "Always says it's over capacity. Useless app."

The team members began pulling all-nighters. To hold back the flood of users, they limited full access to the app and started letting in invitees at a slower pace. By Friday the launch party was cancelled. "I didn't feel it was appropriate to be celebrating while we still had lots of users waiting to get in," says McCue. Four days later employees were still working through the 350 red velvet cupcakes that had been ordered. "We'll have the party eventually," says McCue. Ⓑ —*Barrett Sheridan*

***The bottom line** After rave reviews by tech blogs, Flipboard was overwhelmed by demand for its popular iPad app, a "social magazine."*

Innovator

Rob Wood



The Harvard engineering professor is creating mechanical insects that could be used in agriculture, medicine—and even espionage

Rob Wood sometimes finds himself following a bee across neighbors' yards. "I guess it's just a fascination," says Wood, 33, an associate professor of electrical engineering at Harvard University. As founder of the Harvard Microrobotics Lab, he is trying to identify the unique factors that make a variety of insects efficient. Then he's figuring out ways to replicate those biological advantages in tiny robots. He and eight graduate students are working to build a menagerie of mechanical creatures, from bees to termites. They're using the locomotion of cockroaches and centipedes as models for gizmos that can navigate any terrain, perhaps to seek out victims in earthquake rubble. They're also studying the flap-and-glide of butterfly wings and the hovering of dragonflies to help them make tiny robots that can fly for miles. Conceivably these could be equipped with cameras or sensors and used for espionage.



(Robo-fly)

Wood hopes his robo-insects will be as simple, sturdy, and powerful as the real critters. A horde of machines programmed with the same single-minded determination as real swarms might be useful in agriculture, construction, medicine, and other fields.

In his most ambitious project, Wood is leading a $10 million National Science Foundation-funded project to make robobees. Bionic blossom seekers might be a fix for problems created by Colony Collapse Disorder, an ailment that has wiped out billions of honeybees in the U.S., threatening about $15 billion in almonds, blueberries, and other crops that can't survive without pollination. If the bee population were to disappear, Wood says his robots might be viable substitutes.

The challenges are immense. Once the imitation insects are aloft they need a power supply and navigation system. Early versions of electronic flies, cockroaches, and worms already exist in Wood's lab, and his goal is to have bee prototypes by the time the project's funding dries up in four years. It will take at least another four years to be able to produce thousands of the machines at low cost.

Only when that day arrives will the advantages of each creature become apparent. Termite colonies, for instance, can build enormous nests, some of them more than 300 feet wide. Mechanical termites made by Wood's team might be used to build bridges or dams in situations too dangerous for humans. Wormbots could deliver drug injections in tight spaces, such as the intestinal tract.

Wood's obsession with robotics dates back to his childhood in Syracuse, N.Y., when he spent hours in the basement with his engineer father building radio-controlled airplanes. "I've got a newborn," says Wood. "He and I are going to spend a lot of time just sitting around looking at flies." Ⓑ —*John Lauerman*

Insight ▶ **Tiny robots can mimic some of the biological attributes of insects**

Challenge ▶ **Fitting all the necessary technology on a fingertip-sized bot**

Potential ▶ **Mechanical swarms might be able to construct a bridge or dam**

FROM TOP: PHOTOGRAPH BY ALLAN PENN FOR BLOOMBERG BUSINESSWEEK; BEN FINIO/HARVARD MICROROBOTICS LAB



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Markets&Finance

Low Rates Are Starting To Squeeze Bank Earnings



▶ What started as a blessing for big lenders is becoming a burden

▶ "It's potentially a very dire situation for the overall industry"

The Federal Reserve's gift to U.S. banks—low interest rates that have helped boost profits for the past year and a half—has stopped giving. While lenders can still raise money cheaply, they have started to earn less on new loans and investments. As a result, banks including **Bank of America**, **Citigroup**, and **JPMorgan Chase** are finding it harder to make money.

To aid the economy, the Fed has been keeping its target rate for overnight loans between banks near zero. That has benefited lenders by providing record low costs of funding mortgages and other loans. "That's the gift from the Fed," says Christopher Whalen, a former Federal Reserve Bank of New York analyst and co-founder of Institutional Risk Analytics. "But at the same time, the cash flow on your assets eventually starts to re-price and match the low-rate environment. The zero-rate environment is eventually bad for everybody."

The effects of the squeeze can be seen in the latest quarterly reports. Net interest margins—the difference between what it costs banks to raise money and what they get for lending and investing it—fell by 26 basis points, to 3.06 percent, at JPMorgan from the first to second quarter; 17 basis points, to 3.15 percent, at Citigroup; and 16 basis points, to 2.77 percent, at Bank of America, according to company reports. (A basis point is 0.01 percentage point.) The reduced margins contributed to a drop in net interest income of $1.02 billion at JPMorgan, the second-largest U.S. bank by assets. It fell $849 million at Bank of America, the biggest lender, and $522 million at Citigroup, which is third. **Wells Fargo**, the fourth-largest bank, reported that net interest margin increased by 11 basis points, to 4.38 percent, in the second quarter, the result of higher-than-expected income from soured mortgage loans.

Bank of America Chief Executive Officer Brian T. Moynihan

Change in Net Interest Income

As yields on assets fell, three of the four biggest U.S. banks saw interest income decline from the first to second quarter.



DATA: COMPANY REPORTS

FROM LEFT: NELSON CHING/BLOOMBERG; JOSHUA ROBERTS/BLOOMBERG; CHRIS KEANE/BLOOMBERG; JULIA ZIMMERMAN/LAIF/REDUX

Consumers cut back—but not always page 50 ►



told analysts on a July 16 call that the "sustained low-rate environment" was hitting revenue and earnings and will continue to affect margins. JPMorgan CEO Jamie Dimon told analysts the day before that the bank's net interest margin will continue "coming down a bit as we reposition the portfolio."

The banks may be coping with the low-rate problem for some time. The Fed has signaled that slowing inflation and a sluggish economy will push any interest rate increase into 2011. In a June 23 policy statement the Fed repeated a pledge to keep the benchmark interest rate near zero "for an extended period." Says Matt O'Connor, an analyst at Deutsche Bank in New York: "It's a massive issue. ... Bank of America, Citi, and JPMorgan are feeling the pressure now and will continue to feel pressure for the foreseeable future."

After the Fed brought down short-term interest rates in 2008, banks slashed the rates they offered depositors. The average rate paid on checking accounts was 0.53 percent on July 27, the lowest since February 2005, according to Bankrate.com. Overall, the industry's average cost of funds fell to 1.03 percent in the first quarter of 2010, the lowest on record, according to the Federal Deposit Insurance Corp., down from 3.58 percent in late 2007.

The relatively wide spread between what banks were paying to raise money and what they earned on it helped boost bank profits even as the economy remained weak. JPMorgan's profit on loans and other interest-bearing investments increased to a record $51.2 billion last year after the Fed dropped its target rate to current levels, up 32 percent from 2008 and nearly double the bank's net interest income in 2007, when the Fed's target rate was 5.25 percent.

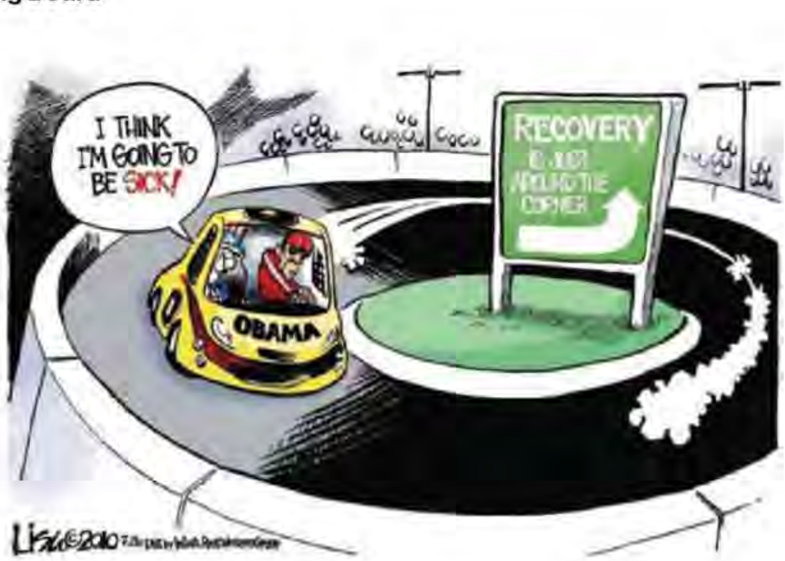
That lucrative spread narrowed as the Fed kept rates low. The average yield banks earn on their investments and loans has dropped to 4.86 percent from 6.93 percent in late 2007.

Another concern for bank profits is a drop in the volume of lending. Banks have tightened their standards and demand has dropped, according to the Fed's senior lender survey. "There's no loan demand, and long-term rates have declined so much," says Deutsche Bank's O'Connor. "So as you look out over the next few quarters, it's potentially a very dire situation for the overall industry."

Nancy A. Bush, founder of NAB Research, an Annandale (N.J.)-based independent research firm, puts it even more bluntly. "We've hit the floor in deposits, you can't go any lower, and your asset yields are declining," she says. "So there's only one way to go for the margin, and that's down."
—*Dawn Kopecki and Dakin Campbell*

The bottom line *The low rates that helped banks boost profits are now having the opposite effect as returns on loans and investments come down.*

Drawing Board



Real Estate

For Sale: Greek Villa. Make Offer

► Luxury homes are being deeply discounted because of the crisis

► "It's a scary place to invest in right now," says one broker

A sunny clime, an ocean view, some ancient ruins out back, and the chance to bump into Tom Hanks at your local taverna. If that sounds good, you're in luck. Greek island villas are being marked down by nearly half as the country's debt crisis curbs demand for holiday getaways.

On Mykonos, an Aegean island famed for its all-night beach parties, a three-story, eight-bedroom villa with a swimming pool is listed at $5.3 million, down from the original asking price of $7.2 million. A three-bedroom home on the island of Corfu has been marked down to $975,000, from about $1.8 million. The price tag on a 4,800-square-foot home in Ekali, a wealthy suburb of Athens, has been cut to $2.6 million, a 48 percent discount. "It's tough this year," says Giannis Ploumis, chief executive officer of real estate broker **Ploumis Sotiropoulos**, which has the Corfu listing. "More properties are on the market and fewer buyers are willing to invest their money."

Greece is in its first recession since 1993 and is counting on a $143 billion bailout from the European Union and the International Monetary Fund to avert a default. Prime Minister George Papandreou, having raised taxes and cut wages for civil servants, is imposing new levies on luxury properties to show voters that the wealthy are helping foot the bill. As part of its austerity program, the government has proposed applying a 2 percent levy on the amount by which a home's value exceeds €5 million ($6.5 million). Owners of homes worth more than €400,000 ($520,000) also face higher property taxes. Such moves are putting pressure on developers and those selling their homes to mark down prices. "It's a scary place to invest in right now," says Mike Braunholtz of **Prestige Property Group**, a U.K.-based broker that sells

THIS PAGE, FROM TOP: PETER STARMAN/GETTY IMAGES; ILLUSTRATION BY LISA BENSON/ THE WASHINGTON POST. OPPOSITE PAGE: PRESTIGE PROPERTY GROUP



Mykonos

$5.3mn

Situated on a large plot of land on the island's southwest coast, this villa is accessible via a private road. There's a swimming pool, seven bedrooms, six bathrooms, and two kitchens laid out over three levels.

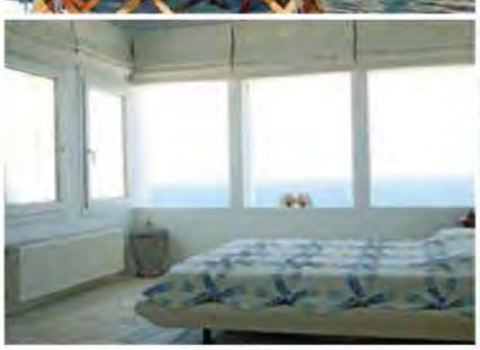


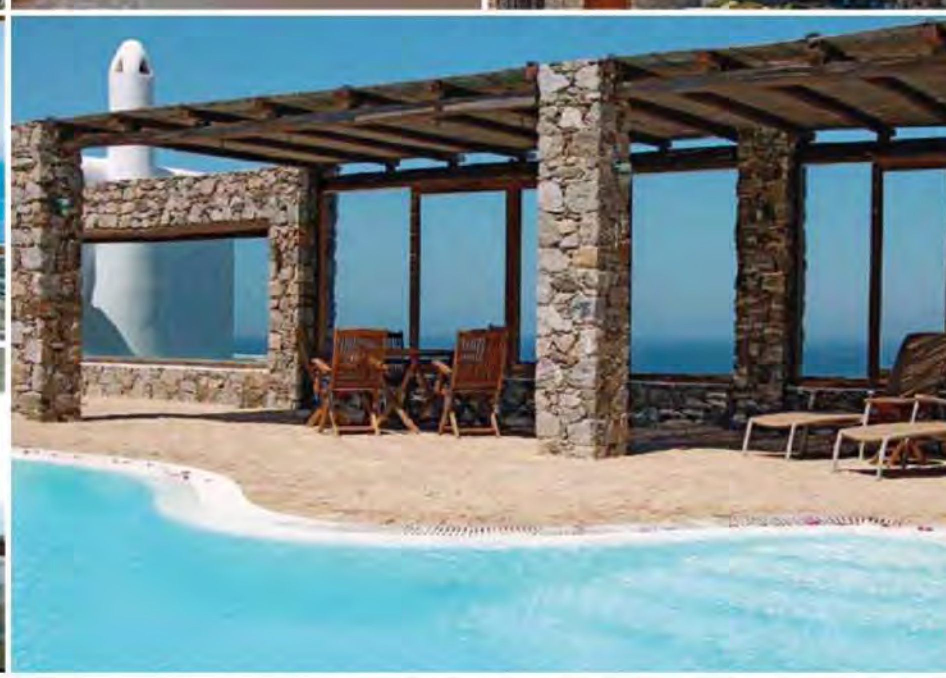












real estate in Greece. "Things aren't going to improve until the economic picture becomes clearer."

Prospective buyers are staying on the sidelines for fear that home values could keep falling. It's a reasonable concern, given that the economy is expected to contract by about 4 percent this year and 2.6 percent the next, according to government projections.

With its many islands and ample oceanfront acreage, Greece for years has been a playground for millionaires. Actor Hanks and his wife Rita Wilson, who together produced the film *My Big Fat Greek Wedding*, own property on the island of Antiparos, according to a spokeswoman for the island's Community Council. The country isn't as fashionable as it used to be, though, says Liam Bailey, head of residential research at **Knight Frank** in London: "People who have a significant amount of money to invest are simply looking at other places."

Prices for luxury homes elsewhere in southern Europe have held up better than in Greece. They've fallen 8 percent to 10 percent in Spain and are more or less flat in Portugal, while in Italy home prices are actually increasing in some cities.

Athens' drive to boost tax revenues, meanwhile, is driving wealthy Greeks to shop abroad for homes. In April, Greek buyers accounted for 6 percent of all purchases in London for properties costing more than $3 million, according to data compiled by Knight Frank. That is double the average of the past three years. *—Sharon Smyth and Natalie Weeks*

The bottom line *The crisis is driving down property values in Greece. But buyer beware: The government is hiking property taxes to boost revenues.*

Personal Investing

The Appeal of a 'Free-Range' Fund Manager

- FPA Crescent's Steven Romick puts his money wherever he sees value
- "If the market moves and you are in cash, you can easily get left behind"

Steven Romick loves his freedom–and so do his investors. Romick has described his $3.5 billion fund, **FPA Crescent**, as "a free-range chicken." The fund can buy stocks or bet against them, stay in the U.S. or go abroad, purchase high-quality debt or junk, or even load up on cash. The flexibility has paid off. The fund's return for the past decade is an annualized 11 percent, better than 99 percent of its rivals, according to Morningstar.

Romick, 47, is both cautious and opportunistic. His first priority is to limit losses: "If you buy an asset and feel comfortable with it even if the worst thing happens, then you are in a good position." He will dive into areas that seem undervalued. In an April 2009 shareholder letter, he said: "We bide our time and wait for slow fat pitches in our strike zone."

The goal is to share in most, if not all, of the market's gains in good times, and use the fund's flexibility to move into different assets, or even go short, in down times. Since its start, FPA Crescent has captured 80 percent of the gains of the Standard & Poor's 500-stock index in months when it rose and suffered 55 percent of the losses when it fell, Romick says. Over that period, the fund was a third less volatile than the index.

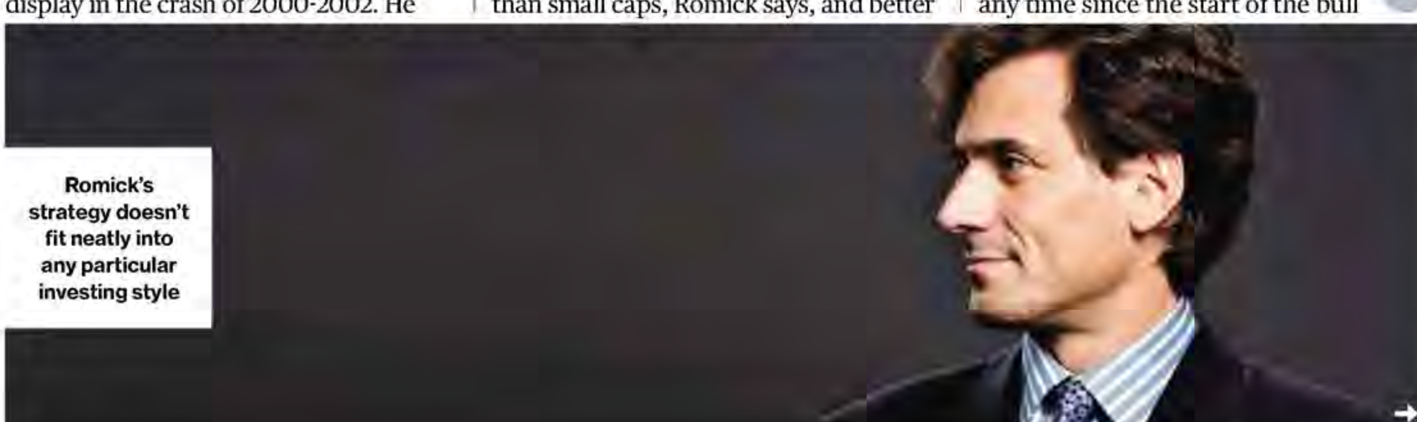
Romick's contrarian streak was on display in the crash of 2000-2002. He avoided tech stocks and held a lot of cash. The fund rose 46 percent during that period, while the S&P 500 lost 38 percent, data compiled by Bloomberg show. In the next big meltdown, in 2008, he limited losses by having almost half the fund in cash. It lost 21 percent during the S&P 500's 37 percent decline.

These days, Romick, who expects the economy to "muddle along," likes energy stocks and large global companies. As of June 30, two top-10 holdings were Los Angeles-based **Occidental Petroleum** and London-based **Ensco**. Shares of Ensco, a contract driller and a big holding since 2001, are up about 68 percent since the end of that year.

Larger companies are better values than small caps, Romick says, and better able to tap into faster-growing foreign markets. **Wal-Mart Stores**, which gets about a quarter of its revenue abroad, was the fund's fifth-largest holding as of June 30. Cash, meanwhile, was 32.1 percent of assets. Big cash stakes can cushion losses; they can also be risky. "If markets move and you are sitting in cash, you can easily get left behind," says Ronald A. Sugameli, whose Wellesley (Mass.)-based New Century Alternative Strategies Portfolio has money in FPA.

Romick's style won't appeal to people who want fund managers to follow a strategy that fits neatly with their overall asset mix. His advice for them: "Give the money to someone else. I'm not the investor for everyone, and I am not trying to be." *—Charles Stein*

***The bottom line** Romick's FPA Crescent mutual fund has used a flexible approach to outperform its peers, with less volatility than the market.*



Romick's strategy doesn't fit neatly into any particular investing style

9.5

BILLION DOLLARS

The amount the mutual fund industry collected in 12-b1 marketing fees in 2009. Regulators are proposing a cap on such fees.

DATA: SEC

Markets

Big Investors Are Bulls; Small Fry Aren't

- While institutions see a stock rally, individuals are deeply pessimistic
- Small investors are "notorious for buying high and selling low"

Individual investors are increasingly bearish, and some institutional investors see that as a good omen. Smaller investors are as pessimistic as they've been in a year, according to a survey by the American Association of Individual Investors. Meanwhile, mutual funds, pensions, and endowments are spending more on stocks than at any time since the start of the bull

THIS PAGE: EVAN KAFKA. OPPOSITE PAGE, FROM TOP: RICKY CARIOTI/THE WASHINGTON POST/GETTY IMAGES; BRAD TRENT

Charlie Rose talks to

David Rubenstein



The Carlyle Group founder, whose clout in Washington dates to a stint in the Carter White House, discusses Obama and business, death and taxes

How well has Barack Obama handled the economy?
It's hard to say how he's done given what he inherited. The stimulus worked in the sense that it kept us from going into a deeper recession. However, in hindsight, it probably wasn't big enough. It was roughly $800 billion. If we had a little more stimulus, probably the economy would not be stalling a bit. One of the other factors is that we have $1.8 trillion on the balance sheet of U.S. companies. They're sitting on the sidelines.

Because they don't have confidence in the future of the U.S. economy?
It's because they're not sure what the regulatory situation is going to be, what the tax situation is going to be. I think they have some concerns about economic growth. The most important thing the President could do is get these business leaders to start spending, investing, and hiring again. And that requires a bit of a bully pulpit and some arm-twisting, perhaps. This is where he can really show great leadership, because he doesn't have financial tools himself anymore. The cash that's available is really in the private sector.

Carlyle has a lot of investments and companies. Are you encouraging them to invest to create new jobs?
We own about 260 companies around the world. We're investing again pretty heavily. We're buying companies we think can grow. Some situations are just not appropriate to make enormous additional expenditures, but some are.

You hear a groundswell of criticism of the President among people who voted for him in 2008. How serious is that discontent?
There's no doubt the President's popularity has gone down. And yes, he has lost support in the business community. He will have to get it back. Other Presidents have had the same problem. Remember, John Kennedy had a famous run-in with the head of U.S. Steel.

No member of the business community is in a significant position in the Administration.
In most Administrations you do have some people who have either served as a CEO of a major company or have been entrepreneurs or professional investors. When there is some reshaping of the Cabinet and White House staff–probably after the midterm elections–the Administration would do well to bring in some people with that kind of experience.

Should the Bush tax cuts be extended?
Right now, members of Congress, Democrats and Republicans, think it's very difficult to not increase taxes for those who have incomes at the level the President promised to protect because so much of the tax revenue comes from people who make $50,000 to $250,000 annually. You can't get enough revenue just by taxing people $250,000 and above. It just isn't realistic. And only taxing a certain part of society isn't fair. Right now, roughly 50 percent of Americans do not pay federal income tax. They do pay FICA taxes and Social Security taxes. I think it's very important that everybody pay something.

What's private equity's public image?
People who make a lot of money and don't pay their fair share of taxes and don't create as much value as we say we're creating. So we have to do a better job of explaining the jobs we've created, the companies we've made better.

Are you prepared–as Warren Buffett is–to see additional taxation for people who make over $250,000?
Absolutely.

Bill and Melinda Gates and Buffett are asking people–and with a reported wealth of at least $2.5 billion, you would be on the list–to give at least 50 percent of their net worth to a philanthropy when they die.
Bill Gates did call me, and I agreed I would participate. Philanthropy is one of the great American inventions. When I turned 54, I read that a white male will, on average, die in 27 [more] years. So I realized I lived two-thirds of my life. What do most people say on their deathbed? They don't say, I wish I'd made more money. What they say is, I wish I'd spent more time with my family and done more for society or my community. So I'm now 60 years old. And I'm doing what I call sprinting to the finish. I'm very concerned that if I slow down and retire, my immune system will relax, and all of a sudden the germs will come in and I'll die at 61. I want to accomplish much more than I did in my previous 60 years because I now have the resources, the access, to do things I couldn't do before. I'm actually more heavily scheduled than I was before, and I love what I'm doing. If I got paid nothing, I'd probably still be doing it.



Watch Charlie Rose on Bloomberg TV weeknights at 8 p.m. and 10 p.m.

Quoted

Home sales are "bouncing along the bottom. ... The future is going to be dependent on job growth. There's no demand because confidence is weak and employment is weak."
—Eric Green, chief market economist at TD Securities, commenting on the June home sales figure. The annual pace, 330,000, was the second-lowest on record.



market. The last time money managers and individuals were this far apart was at the beginning of 2009, just before the Standard & Poor's 500-stock index began a 63 percent rally, data compiled by Bloomberg show. "It's been the individual investor that's been a good contrarian indicator," says Mark Luschini, chief investment strategist at Philadelphia-based Janney Montgomery Scott.

Stocks represented 68 percent of institutions' holdings in July, the most since April 2009, a Citigroup survey shows. The ratio of bullish to bearish individuals responding to the AAII survey fell to 0.68, the lowest reading since July 2009, based on a four-week average. AAII's measure of pessimism peaked on July 8 at 57 percent.

Some money managers believe that worries about a double-dip recession, which have rattled the markets since April, have driven stocks too low. Bill Miller, chairman and chief investment officer of Legg Mason Capital Management, recently sent investors a letter calling this a "once in a lifetime opportunity" to buy shares of large U.S. companies. Individuals have pulled $41.2 billion from mutual funds that hold U.S. stocks since April 2009 and have piled more than $470 billion into bond funds, according to Investment Company Institute data.

Says Janney Montgomery Scott's Luschini: "The stock market will continue to advance ... ultimately pulling along retail investors notorious for buying high and selling low."
—Lynn Thomasson

The bottom line *Sentiment among individual investors can be a contrary indicator, so their skittishness may bode well for the stock market.*

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Bankruptcy

More Than $1 Billion to Clean Up After Lehman

▸ The investment bank may need five more years to pay claims

▸ "This is going to be the most expensive Chapter 11 case ever"

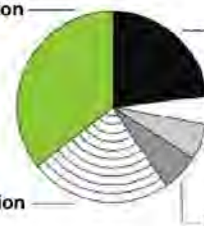
Untangling the affairs of **Lehman Brothers** may end up costing more than $1 billion. So far the investment bank, which has been in bankruptcy since September 2008, has paid its lawyers and managers $873.1 million for 21½ months of work, or almost $1.4 million a day. "This is going to be the most expensive Chapter 11 case ever," says Stephen J. Lubben, a bankruptcy law professor at Seton Hall University.

Enron's three years of bankruptcy cost $793 million for legal and other advisory fees, according to the database of Lynn M. LoPucki, who teaches bankruptcy law at the University of California at Los Angeles. Including Enron's interim management would add more than $100 million to the total cost, he says.

The restructuring firm Alvarez & Marsal, which provided Lehman with its current chief executive officer, Bryan Marsal, led the payments with $311.6 million for management through June, according to a July 22 filing with the Securities & Exchange Commission. Weil, Gotshal & Manges, the New York-based law firm, collected $200.6 million for acting as Lehman's lead bankruptcy law firm. Milbank, Tweed, Hadley & McCloy got $56.5 million for advising Lehman's creditors' committee.

The price of failure
A breakdown of Lehman bankruptcy costs:

$873.1 million spent in 21.5 months



*Includes tax, accounting, and legal services, and consultants

DATA: SEC FILING

In September 2008, Lehman filed the biggest U.S. bankruptcy ever, with assets of $639 billion. It has said it may spend five more years selling assets to pay unsecured creditors 14.7¢ to 44.2¢ on the dollar. "There were $1 trillion in claims filed," Marsal wrote in an e-mail. "This case has been without significant controversy, and disputed creditor issues have been at a minimum. It has been pretty efficiently managed." *—Linda Sandler*

The bottom line *Lehman Brothers' bankruptcy, the biggest on record, is on its way to surpassing Enron's as the costliest to resolve.*

Housing

Young People Are Filling Vacant Apartments

▸ With job prospects improving, many seek their own places

▸ "I was tired of depending on my family for housing"

Apartment landlords are seeing a surge in rentals as mounting foreclosures reduce homeownership and an improving job market prompts young adults to find their own places. The number of occupied apartments increased by 215,000 in the 64 largest U.S. markets in the first half of the year, according to MPF Research. That's almost twice the units added in all of 2009 and the most since the firm began tracking the data in 1992. The vacancy rate declined to 6.6 percent in June from 8.2 percent in December. "Overall demand is pretty stunningly strong in the first half," says Greg Willett, a vice-president at the Carrollton (Tex.) firm.

The economy's recovery from the worst recession since the 1930s hasn't been strong enough to prevent home foreclosures, which can lead dispossessed homeowners to seek rentals. Yet it has created some new jobs. Employers began hiring again in January, adding an average of 147,000 jobs a month through June, according to the Labor Dept. Employment for people 20 to 29 years old—a key group for landlords—rose in May and June over the same months in the previous year for the first time since the end of 2007.

OPPOSITE PAGE, FROM TOP: DANIEL ACKER/BLOOMBERG; LIONEL BONAVENTURE/AFP/GETTY IMAGES; JOSHUA ROBERTS/BLOOMBERG

That may be enough to have persuaded some people sharing housing with relatives to get their own places, says Mark M. Zandi, chief economist of Moody's Analytics. "Given how hard it is for families to live together for very long, they moved out as soon as they got a job or even thought they could find one," he says.

Mike Odenthal moved to the New York area in January from San Diego in search of a communications job, sleeping on his younger brother's couch in Jersey City, N.J. He moved out four months later after his brother put the condominium up for sale, eager to live on his own. "I was tired of depending on my family for housing," says Odenthal, 27, who also stayed with his parents in Jersey City. He found a roommate and moved July 1 to Manhattan's Upper East Side, paying $700 a month for his share of the rent. The next morning he got an offer to work at a public-relations firm.

Thanks to Odenthal and people like him, apartment owners have been able to raise rents. Effective rents, or what tenants pay after concessions from landlords, increased 1.4 percent in the biggest markets in the first half of the year, according to MPF Research. Rents may rise 4 percent to 6 percent in 2011 and 2012, Willett says, compared with about 2 percent this year. Landlords won't be able to jack up rents too aggressively, he adds, because unemployment remains high at 9.5 percent and declines in home prices have made it no more expensive to buy than to rent in about half of larger markets around the nation.

Riverstone Residential Group of Dallas, which manages 175,000 units in 30 markets around the country, has reduced average concessions to about a half-month's rent from about two months' a year ago. CEO Walt Smith says he expects rents to go up significantly by 2012 as the apartment supply tightens because so few new units are being built. "Landlords are cautiously testing the strength of the submarket their property is in to see if [it] will withstand small rent increases," Smith says. "In most markets, they've been successful." Ⓑ —*Prashant Gopal*

***The bottom line** Improving job prospects for young people are encouraging them to move out on their own, a boon for apartment landlords.*

Bid & Ask

by Cristina Lindblad



Real Estate

The Duke-Semans mansion on New York's Fifth Avenue has sold for **$44 million**, and the buyer is Mexican billionaire Carlos Slim, according to *The Wall Street Journal*. Built in 1901 by the ancestors of tobacco heiress Doris Duke, the Beaux Arts townhouse has 12 bedrooms, 14 baths, and 3 elevators.

Settlements

$23.4mn

Amount that General Electric agreed to pay to settle SEC charges that the company spent $3.6 million on kickbacks to win contracts in Iraq during the waning days of Saddam Hussein's rule. Three former GE employees were indicted in a separate Justice Dept. probe into bid rigging on U.S. municipal contracts.



Sports

Alberto Contador took home **$64,600** in Tour de France winnings after splitting the **$580,000** prize with his eight teammates. That seems paltry next to the **$1.5 million** compatriot Rafael Nadal got for winning at Wimbledon this year.

Social Networking

Hedge fund Tiger Global Management paid **$20 million** for a 1 percent stake in LinkedIn, giving the professional networking website a theoretical value of more than **$2 billion**. Tiger's investment follows its December purchase of shares in Zynga Game Network, another Internet company that, like LinkedIn, is a candidate for an initial public offering.

Telecoms

$9.7bn

Amount Spain's Telefónica is paying to buy Portugal Telecom's stake in Vivo Participacoes, Brazil's No. 1 wireless carrier. The deal brings an end to a protracted tug-of-war for control of Vivo. Separately, Portugal Telecom offered $4.8 billion for a 22 percent stake in Telemar Norte Leste, Brazil's largest landline operator.

Autos

General Motors said its Chevrolet Volt electric car will have a starting price of **$41,000**, with lease terms of $350 a month with a $2,500 down payment. The Volt is priced at a premium over Nissan's all-electric Leaf, which is scheduled to go on sale in November for **$32,780**. GM says the higher price is justified by the Volt's longer driving range.

Oil

$3.4bn

Amount Russia's Lukoil is paying to buy back 7.6 percent of its stock from ConocoPhillips. The No. 3 U.S. oil producer says it plans to sell its remaining 12.4 percent interest by the end of the year as part of a $10 billion divestiture program.

Sovereign Wealth Funds

Malaysia's sovereign wealth fund, Khazanah Nasional, prevailed in a bidding war for control of Singapore's Parkway Holdings, Asia's biggest hospital operator. Khazanah's **$2.6 billion** offer topped one by India's Fortis Healthcare. The deal will allow Khazanah to capitalize on rising health-care spending in the region.

Banking

Seven U.S. banks with deposits totaling about **$2 billion** were seized by the Federal Deposit Insurance Corp. over the weekend of July 24-25. FDIC Chairwoman Sheila Bair has said she expects the number of bank failures this year to surpass 2009's total of 140. The casualty count so far in 2010 is 103.



Americans are broke and depressed — and also swilling $3 lattes and waiting

The New

"I can't give up buying really good shoes."

"It's been a good couple of years for me. I just bought a house on Friday."

"I watch my electric bill and try to save on utilities so I can shop more."



"I've definitely noticed that people aren't spending like they used to."

"I'm not as concerned about my own well-being as I am about that of our country."

"I haven't given myself any presents."

"I cut my Internet. I'm cutting everything. My most outrageous thing is to go out to eat or to a movie."

"I'm starting to get to the age when I'm thinking about a career, and I just got let go from my job."

"I'm buying more of the necessities than extras and shopping sales."

on line for iPhones. Welcome to the schizophrenic economy. By Devin Leonard

Abnormal



"Maybe I'll cut back on entertainment, but not on groceries. I don't want to buy yucky food."

"I traded up my cell phone. I didn't have the money, but I did it anyway."

"I just spent two weeks in Europe."

"We wanted new windows for the house, but we're waiting on that now."

"Our company has been buying more stores and hiring more people instead of cutting back."

"We scaled back our vacation from two weeks to one this year."

"We find more creative ways to have fun cheaper. I don't think it's affected me much, but we're minimalists."

"I am not doing anything at all for fun."

"I wouldn't give up the Phillies."

In March, Ralph Ronzio went to a warehouse in a seedy part of Orange County, Calif., and watched a guy auction off his condo for half what he'd paid for it. Ronzio had bought the place for $329,000 in 2005, when he moved to Southern California from Rhode Island to take a job at a data-storage company. It was the first place he'd ever owned. "It was totally my bachelor pad," he says. "Not much inside other than the usual leather couch and the big screen TV. My fiancée made me sell the couch."

That wasn't the only thing that changed when Ronzio got engaged. His fiancée had two young children, and there wasn't enough room in the condo for all four of them. So last year, Ronzio bought a house nine miles away and they all moved in. He figured he could rent the condo and cover his costs. He figured wrong.

The more he thought about the money he was losing, the more it stressed him out. Finally, Ronzio enlisted the help of a firm called You Walk Away and did exactly that from the remaining $319,000 on his condo mortgage. When the bank foreclosed, he says he felt an enormous sense of relief. He also had more cash. He and his fiancée took the kids to Disneyland. Ronzio, 31, gave himself a treat as well. "I bought myself an iPad," he says.

It used to be that someone like Ralph Ronzio could be fairly certain of the outcome when spending a few hundred thousand dollars on real estate. Housing prices were headed in only one direction. You could surf the boom and borrow against your home equity to pay for all manner of splurges—a vacation, a flat-screen TV, the latest Apple gadget. It may have looked like a lot of debt on paper, but considering that housing prices nearly doubled from 1999 to 2006, there was always an escape hatch: Sell your house and make enough money to pay it all back.

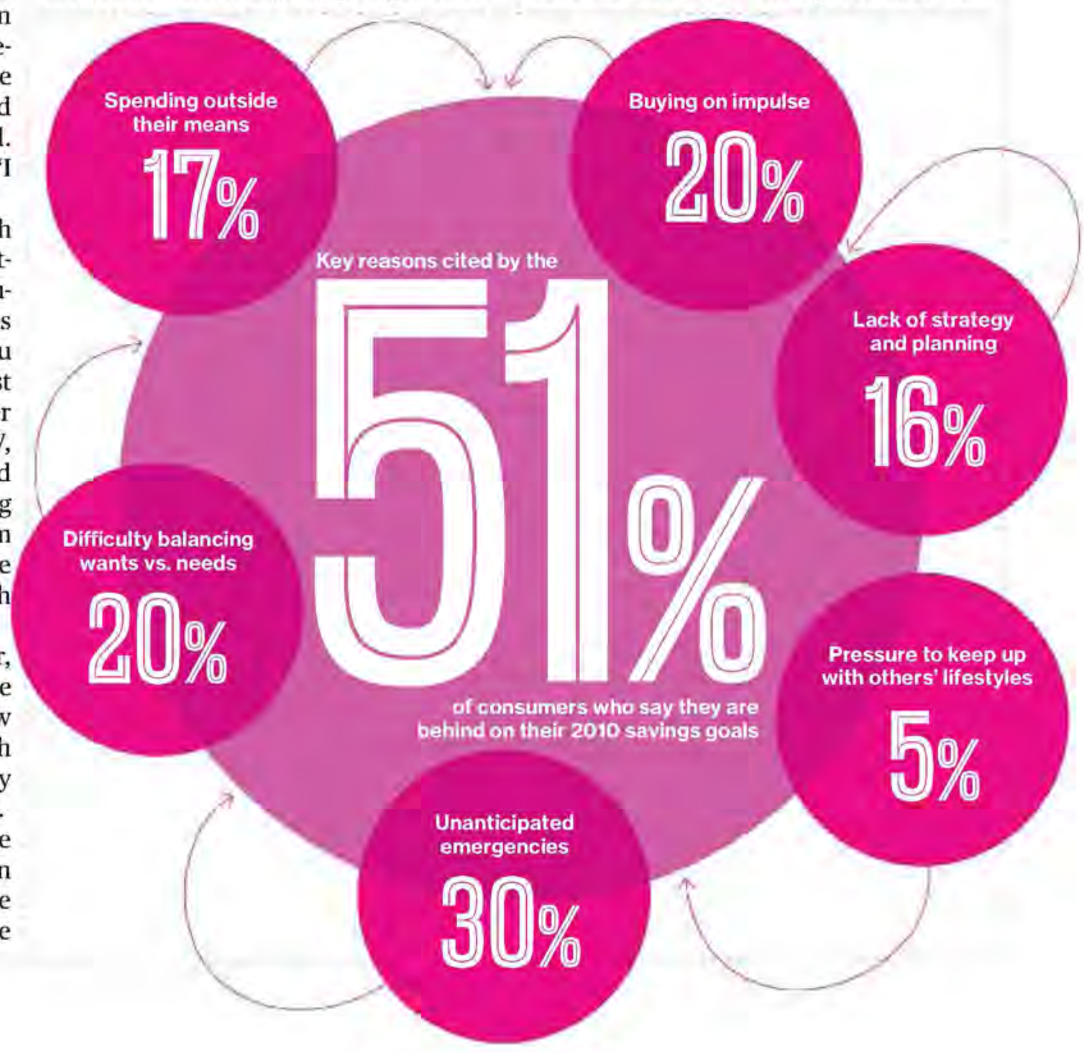
That was the old normal. Last year, Mohamed El-Erian, CEO of PIMCO, the influential bond shop, declared a "new normal," a global realignment in which the U.S. consumer, no longer a hungry monster, became cautious and subdued.

The current circumstances might be better described as the new abnormal, in which no one knows anything. In June the Conference Board Consumer Confidence Index fell 9 points on the heels of an 11 percent drop in the S&P 500 the month before. New housing starts were as bad as they had been in eight months. Meanwhile, the unemployment rate still hovers near double digits. That's 14.6 million Americans out of work. Federal Reserve Chairman Ben Bernanke only added to the anxiety with a July 21 declaration that the economic outlook is "unusually uncertain."

So who are all those people at the mall? It's easy to forget that a 9.5 percent unemployment rate means that roughly 9 out of 10 Americans in the workforce are still employed. "Some consumers are probably liquidity-constrained," says Kenneth Rogoff, Harvard University professor and former chief economist at the International Monetary Fund. These are "the ones who are probably not the ones buying iPads. But 90 percent of Americans do have a job, and maybe 70 percent are confident about them. And maybe half of those have liquidity."

On a recent afternoon, Lucy Johnston, 37, an accountant from Tulsa, Okla., could be found at the Fashion Show mall on the Strip in Las Vegas. She's cutting back on shopping and eating out because of the recession. "It's really tough right now," Johnston says. "I don't do many full-on spa days anymore." Yet there she was, shopping and vacationing in Vegas with her husband. "We've pulled out all the stops. We're staying at the Bellagio."

The new abnormal has given rise to a nation of schizophrenic consumers. They splurge on high-end discretionary items and cut back on brand-name toothpaste and shampoo. Companies like Apple, whose net income jumped 94 percent in its last quarter, and Starbucks, which is enjoying a 61 percent increase in operating income over the same time frame, are thriving. Mercedes-Benz is having a record sales year; deliveries of new vehicles in the U.S. rose 25 percent in the first six months of 2010. Lexus and BMW were also up. Though luxury-goods manufacturers like Hermès and Burberry are looking primarily to Asia for growth, their recent earnings reports suggest stabilization and even modest improvement in the U.S. "Last September, retail started to recover on a very narrow basis," says Michael Niemira, chief economist for the International Council of Shopping Centers. "Most of the industry was really weak. It wasn't until the end of the year that you saw any momentum. It was all dollar stores and luxury. You have this





Bloomingdale's in New York City: Impulse buying can be triggered by both up and down markets

bifurcated market. This year, it started to move to the middle a little. Now it's kind of moved back to the edges."

Of course, some of this is a reminder that the rich have been largely shielded from the recession's ravages. "All of my customers think we are out of the recession," says Marika Baca, an associate in the women's department at Barneys New York. "This time last year, it was bad. But now the women who were reluctantly picking up one piece are easily buying three." Aspirational middle-class consumers say they are also yearning to get their hands on the same high-end merchandise, just as they did in better times.

In such an environment, optimism about the economic future ebbs and flows constantly, with far-reaching consequences for a nation in which consumer spending accounts for 70 percent of the gross national product. It's an economy that defies smooth trend lines and suggests an EKG-shaped recovery–a sequence of mini booms and busts as consumer fads and pent-up demand drive sales, until the impulses fade. Erratic behavior is everywhere, even at Family Dollar Stores. "My feeling is that you can see week-to-week differences today that are far more volatile than what we have been seeing," said R. James Kelly, the company's president and chief operating officer, reporting a quarter with a 19 percent increase in net income.

The financial press, you may have noticed, is obsessed with consumer confidence. The collective hope is that at some point it will start trending steadily upward, signaling that the recession is finally over. And that's exactly what seemed to be happening earlier this year. The stock market had rebounded. Consumer confidence was on the upswing. It looked like the economy took on aspects of normal behavior–and then it all fell apart. In June the stock market gave back 4 percent of its value. And like teenagers suffering mood swings, consumers lost their nerve all over again.

On July 27 the Conference Board reported that confidence was at a five-month low, which it blamed on job insecurity. Lynn Franco, director of the board's consumer research center, served up an appropriately grim metaphor in a statement: "Concerns about the labor market are casting a dark cloud over consumers that is not likely to lift until the job market improves."

Not everybody's consumer diagnosis is the same, though. Shortly before the Conference Board released its finding, *Consumer Reports*, the venerable 74-year-old magazine, unveiled the results of its monthly telephone survey about economic issues. It found that consumers had ramped up their retail spending by an average of $40. Though major purchases like

Consumer Reports'
Trouble Tracker Index



Survey-based measure of financial difficulties faced by consumers in the past 30 days, such as trouble paying bills. A rise indicates more trouble.

cars remained unlikely (Mercedes drivers must be hard to reach in phone surveys), Americans were planning to spend more on appliances and electronics.

Ed Farrell, a director of the Consumer Reports National Research Center, says: "We just focus on what's happening this month. We don't ask people want they think the business climate is going to be like in a year. If these people could tell us that, we'd all be very well off."

American Express released the results of its consumer survey on July 13, showing more willingness to spend, dampened somewhat by guilt and despair on the part of some of these

PREVIOUS SPREAD: PHOTOGRAPHS BY DARIN BACK, CHRIS CRISMAN, AND JONATHAN SPRAGUE FOR BLOOMBERG BUSINESSWEEK. THIS PAGE: MATTHEW MCDERMOTT/POLARIS



Shoppers in Wellington, Fla., were ready for the iPhone 4's debut on June 24

same respondents. The credit-card company found that 51 percent of consumers had fallen behind on their annual savings plan, in part because they were either making impulse purchases or simply spending beyond their means. There it is: gloom, muted optimism, and wild abandon.

Yet what if these things aren't exclusive in the new abnormal? Frank Veneroso, an investment strategy adviser in Portsmouth, N.H., closely follows the nation's saving rate. It was his opinion that high debt levels and economic fears would force Americans to rein in their spending and increase their savings. In the early part of the recession, that's precisely what happened. Then it stopped happening. Veneroso theorizes that the nation's wealthier citizens were so relieved when the stock market rallied last year after the financial crisis that they went on a "celebratory spending spree." He believes that recent market turmoil will put a stop to those good vibes and that savings will start to inch back up.

Except market rallies are not the only thing that emboldens consumers. Market dips can also loosen up purse strings, says Dan Ariely, a professor of behavioral economics at Duke University and author of *Predictably Irrational: The Hidden Forces that Shape Our Decisions*. When people get freaked out by market gyrations, Ariely says, they see the advantage of shopping over putting money into a mutual fund that might tank. "If they lose money by spending it on something," says Ariely, "at least they have something to show for it."

The point is that, for consumers looking for a reason, ups and downs can both provide a justification for spending. Stephanie Redmond, a 25-year-old electronics worker, talked about her financial woes as she shopped at the Dolphin Mall in Miami. She described herself as pessimistic about the economy. "I don't see it getting any better. I mean, I need a new car, but I don't plan on getting one anytime soon." Instead she recently bought a plane ticket to New York and stayed in a Times Square hotel. "It was my first time, so it was a lot of fun," she admits.

"It's just been a slow walk out of the woods," says Columbia professor Ran Kivetz. "At the end of the day people are saying, 'There is still risk. I gotta cut back.' But this is not a typical one-year recession. Life has to have some normalcy. I have to have some luxuries."

At the Woodfield Shopping Center in Schaumburg, Ill., Michelle Rodriguez, 39, a part-time cafeteria worker at a local high school, shared her litany of complaints. She said she cut back considerably after losing her old full-time job two years ago as a receptionist at Kraft. "I think the economy has a ways to go," she sighed. "I don't make nearly as much as I used to make." And yet she confessed to purchasing a 46-inch flat-screen Sony TV in the last year. And now she was waiting for help in the Genius Bar line at the Apple Store.

One way of understanding Apple's recent success—the company announced "all-time record" revenues of $15.7 billion for its quarter ending on June 26—is that the iPad is perfectly positioned as a compromise product for people who crave the kick of a new Apple gadget but don't want to spring for a Mac. "I was talking to someone recently who said to me, 'I bought the iPad because I can't afford a new iMac,'" says Carla Serrano, chief strategist for TBWA/Chiat/Day, Apple's advertising agency. "O.K., fine. But the iPad does hardly anything that an iMac can do." She believes that the recession is making people think they need to come up with that she describes as "post-rational" justifications for their extravagant purchases.

The performance of Starbucks suggests that everyday luxuries have also not been wiped out. On July 21 the coffee chain announced a "record" quarter with same-store sales growth of 9 percent—the

LANNIS WATERS/THE PALM BEACH POST/ZUMA PRESS



biggest increase since the second quarter of 2006, the peak of the old normal. CEO Howard Schultz boasted of Starbucks' new products, like its "customizable Frappuccino campaign," as well as Via, its new instant coffee, which is pitched as a budget item, though not exactly priced like one when compared with other instant competitors. (A 12-packet box of Via goes for $9.95.) Starbucks is the lower-end corollary to Apple, a purveyor of expensive treats. Stephanie Redmond, the Miami electronics worker, may not buy the new car she needs, but give up Starbucks? Never. She has to have it "every day!"

Mass marketers have a tougher time seducing consumers with psychological value. Burt Flickinger, a retail consultant based in New York, says Procter & Gamble is struggling to keep people from abandoning its Ivory soap and Crest toothpaste for generic brands. The irony is that it is often the same people juggling iPhones and venti lattes who are open to switching to off-brand laundry detergents. According to Flickinger, better-educated shoppers understand how little difference there is in quality on many household items.

They may also be sneaking into discount retailers for these deals. "The dollar store is the new Target," says Al Moffatt, CEO of Worldwide Partners, a Denver-based advertising company. "You go in there to buy shampoo for a buck so you can go to Starbucks and justify spending $3 for a coffee." Moffatt admits that he and his wife recently did their own variation on this recessionary theme. On a trip to Oregon, they bought cheap towels at a discount store before hitting a pricey spa.

Ran Kivetz, a professor of marketing at Columbia Business School, has done extensive research on consumer psychology. He argues that consumers' brains lack a line that separates spending from saving. Instead we practice a certain amount of thrift so that we can justify blowing a large sum frivolously.

Kivetz says the recent downturn has made consumer thinking even more conflicted. In the short run we feel good when we save. In the long run we tend to regret the denial of a spending outlet. "We feel guilty" about spending, Kivetz says, which can lead to more irrational purchasing.

And that, says Kivetz, is exactly what's happening now. Consumers were quick to reduce spending when the recession arrived. Then the recession lasted longer than expected, and the new abnormal set in. The economy started to improve. Then it appeared to worsen. Kivetz says there is only so long we can suppress our need to spend. "It's just been a slow walk out of the woods," he sighs, "and it's so complicated. The things going on in Europe are frightening. There are problems with China, with our government debt, and bank debt. At the end of the day, people are saying, 'There is still risk. I gotta cut back.' But this is not a typical one-year recession. Life has to have some normalcy. I have to have some luxuries."

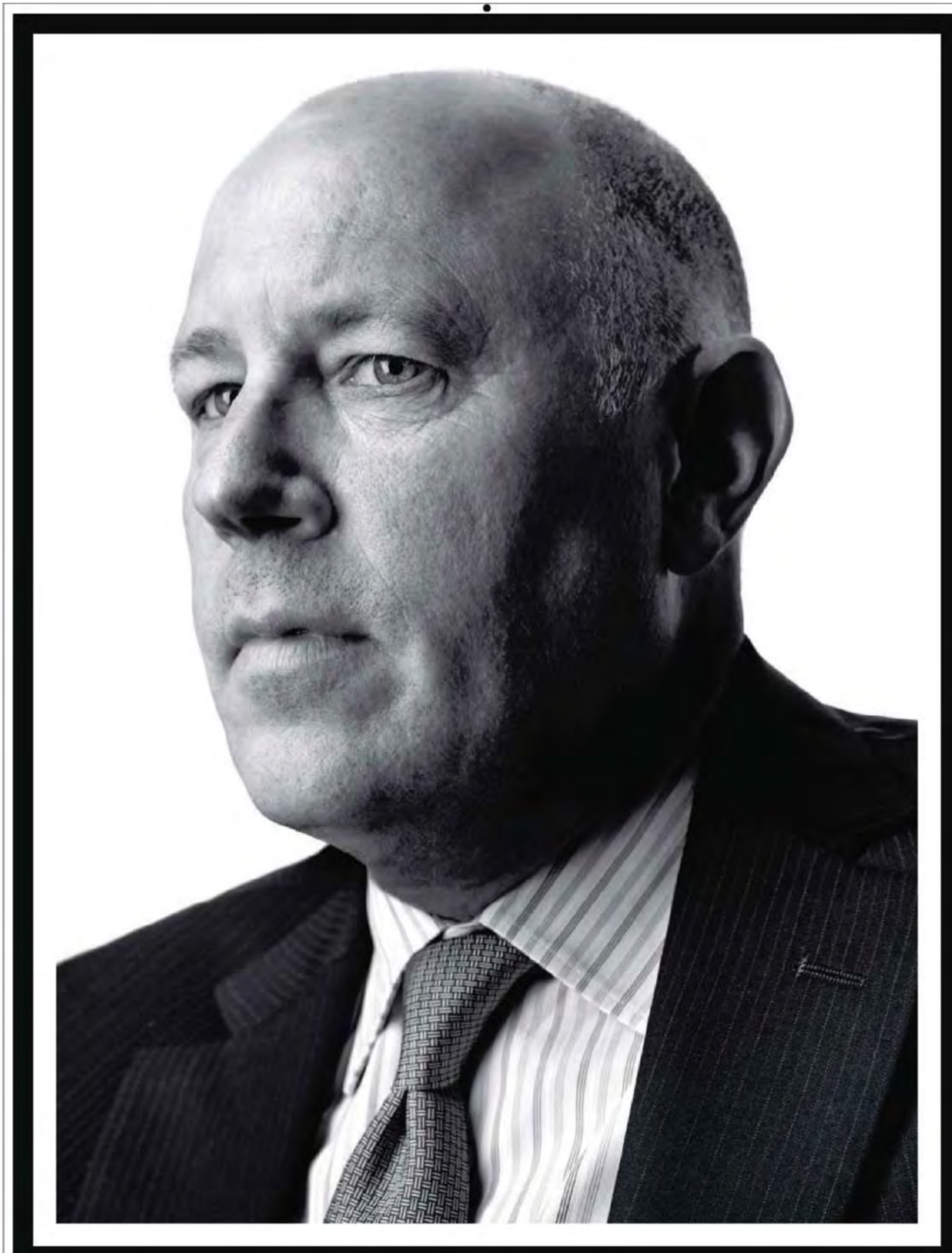
There was little evidence of the recession at a recent lunchtime in the Mall of America in Bloomington, Minn. The nation's largest mall was full of shoppers drinking expensive coffee and toting bags of electronics and expensive shoes. Some of them were there on vacation. Why not? The Mall of America doesn't just have 520-plus shops, it has an enormous amusement park and a 1.2 million gallon aquarium. The opportunities to splurge are almost overwhelming, and sales are up 9 percent so far this year.

Mellissa Williams, a 30-year-old teacher from Laredo, Mo., was looking for sneakers with her two children at a sporting goods store. "We'll be looking at price tags a little more than we normally would," she said. And yet she had come a long way to look for deals. What was her biggest splurge in the last six months? "Probably this trip," Williams said. B

WITH REPORTING BY MICHAEL BATHON, MARY VAN BEUSEKOM, IRA BOUDWAY, CHRIS BURRITT, RYAN FLINN, ROCHELLE GARNER, JENNIFER JOHNSON, THEO KEITH, RYAN MCAFEE, JULIA MORPURGO, PHAM-DUY NGUYEN, SOMMER SAADI, ROBERT STRAUSS, MICHAEL WHITE, CAROLINE WINTER

20%

Of consumers have purchased something over the past 30 days they wouldn't have felt comfortable buying six months ago



In the financial rubble, Jeffrey Sprecher found profit remaking the market for credit default swaps. His tight bond with banks has critics worried that he hasn't made it safer

By Chad Terhune. Photograph by Mike McGregor

Sultan of Swaps

After buying a $10 million mansion in Atlanta last year, Jeffrey C. Sprecher rolled up his sleeves and repaired the furnace himself. He also rewired the sound system. Now the 55-year-old chief executive officer of Intercontinental-Exchange, known as ICE, is busy remodeling the $25 trillion market for credit default swaps (CDS), the derivative contracts that played a starring role in the financial breakdown.

Sprecher founded ICE a decade ago as an online marketplace for energy trading. Since getting into the business of CDS clearing—serving as a middleman in transactions involving the derivatives—ICE has become dominant. Between its operations in the U.S., called ICE Trust, and Europe, Sprecher's company has cleared more than $10 trillion in such swaps; its closest rival, CME Group, has cleared $192 million.

Sprecher built such a huge lead by acting fast. Mere weeks after the federal government came to the rescue of AIG, which had been driven to its knees by its massive CDS exposure, he cut a deal with 10 of the world's largest banks, including Goldman Sachs, Morgan Stanley, and Bank of America, to clear their trades in exchange for sharing the profits with them. "I outmaneuvered the other service providers," Sprecher says in an interview at his Atlanta headquarters, wearing a black suit, open-collared dress shirt, and a $40,000 Patek Philippe watch that shows the time in 24 zones. Sprecher's firm and its partners stand to profit even more from President Barack Obama's July 21 signing of the financial regulatory reform act, which requires most standard derivatives to be cleared through a third party such as ICE.

The CDS was developed as a way for bondholders to offset the default risk of companies and countries. Over the past decade the market has experienced explosive growth as investors turned to the swaps to bet against financial instruments they often didn't own. It's the hope of Wall Street reformers that a CDS clearinghouse will bring order and clarity to the market, as well as a safety net. ICE guarantees every transaction between buyer and seller, effectively reducing the impact of a default by a firm such as Lehman Brothers by spreading the risk among the clearinghouse members and collecting appropriate collateral on every trade. ICE so far has contributed $120 million to its two clearinghouses' guaranty funds, its maximum exposure in the event of a major default or meltdown in the CDS market. Barring that, clearing swaps is a relatively high-margin business. ICE is telling analysts that it expects revenue of about $70 million this year from CDS clearing, with 16 percent to 20 percent of that falling to the bottom line.

That Sprecher uncovered a great profit-making opportunity in the rubble of the financial crisis is clear. Over the past year, ICE's shares have risen 18 percent, boosting his personal stake to more than $192 million. Whether his clearinghouse, so finely tailored to the interests of the major banks, contributes to a safer, more transparent financial system is a matter of contention.

Sprecher grew up in Madison, Wis., the son of a nurse and a life-insurance salesman who still goes into the office at age 80. After graduating from the University of Wisconsin in 1978 with a degree in chemical engineering, he worked for the air-conditioning company Trane, which allowed him to get his MBA from Pepperdine University while working full-time. He left Trane in 1983 at the age of 28 to form a power-plant developer, Western Power Group.

While building that company, Sprecher took some weekends off to race open-wheel Formula Fords, the beginning circuit for Formula 1. Later, in the early years of building ICE, Sprecher would challenge colleagues to races at a local go-kart track after work and join in sushi and beer afterward.

Financial regulators, Sprecher says, "will find fault, I'm sure, with some of the things we have done"

Using money Western Power received as part of a multimillion-dollar lawsuit settlement, Sprecher purchased Atlanta-based Continental Power Exchange in 1997 from the MidAmerican Energy utility. That power exchange became the foundation for ICE in 2000.

That year, Sprecher presented his business plan for online energy trading to Goldman's Gary Cohn and Morgan Stanley's John Shapiro, who agreed to do some of their energy business through ICE in return for equity stakes in the start-up, according to Sprecher. They also recruited other industry players such as BP and Shell to trade on the new online system, he says. The banks sold most of their stakes after ICE went public in 2005.

Shapiro, who retired as Morgan Stanley's chief of global commodities in 2008, recalls flying to Atlanta to meet Sprecher and reaching a deal on the spot. "We had already talked to a number of other players and we wanted him to be our guy," Shapiro says. At the time, Wall Street firms and energy companies were looking for a competitor to EnronOnline. Shapiro credits Sprecher for not allowing his ego to sidetrack a deal. "Jeff was very smart to recognize he had to give away a lot of equity. It's better to have a small piece of something that's very successful. There were a lot of failures from people who tried to do it all themselves," Shapiro says. "There were a lot of dreamers and ego guys in that space early on. Jeff didn't fit those modes." Cohn, now Goldman's president and chief operating officer, declined to comment.

Energy trading surged at ICE in 2001 after its larger rival, Enron, blew up. That same year, ICE expanded into crude oil by acquiring the International Petroleum Exchange in London. Renamed ICE Futures Europe, this London exchange trades half of the world's crude and refined oil futures. Its benchmark Brent crude oil contract is used to price two-thirds of the world's oil supply, according to ICE.

Sprecher, a self-described workaholic, found more than money at ICE. In 2004 he married Kelly Loeffler, 39, the company's vice-president for investor relations and corporate communication. She earns $470,000 annually and works in an adjacent office. "I'm a really hard worker, so if my wife wasn't in the building it would be much harder on our relationship," says Sprecher, who earned $6.8 million last year.

The couple's 2009 purchase of a European-style mansion in Atlanta, which has 7 bedrooms, 11 bathrooms, and 14-foot-high ceilings, set an Atlanta-area record, at $10.5 million, for the most expensive home sale, according to real estate research firm SmartNumbers. The home is next door to the mansion once owned by former Coca-Cola President and Atlanta icon Robert Woodruff.

The couple, who have no children, host charity events as well as frequent political fund-raisers, including one for former Republican Presidential candidate Mitt Romney. "We're not necessarily showy people," says Sprecher. "The only way that we can really rationalize having a big house is to open it up for fund-raisers and events."

On Sept. 9, 2008, six days before Lehman filed for bankruptcy, Sprecher and his ICE team sat down with regulators at the Federal Reserve building in New York to pitch Sprecher's plan for a clearinghouse. In a drab conference



Sprecher bought his home for an Atlanta-area record $10.5 million

room with folding tables, Sprecher gave Fed officials and representatives of the New York State Banking Dept. a detailed PowerPoint presentation and fielded questions about how ICE would manage the risks of credit default swaps.

Sprecher also began negotiating with 10 of the biggest banks to acquire Clearing Corp., their existing clearinghouse based in Chicago, and lock up their CDS allegiance. On Oct. 30, 10 days after disclosing his plans to regulators, Sprecher announced ICE's agreement to acquire Clearing. ICE agreed to pay $39 million and split the future profits 50-50 from the clearinghouse.

Rival CME was working with Chicago hedge fund Citadel Investment Group to launch an electronic exchange and CDS clearinghouse, a direct threat to the over-the-counter trading dominated by the large banks. When the Clearing deal was announced, CME Chairman Terry Duffy said his company offered the "truly neutral solution" and doubted the market would accept the ICE clearinghouse, since the banks had such a vested interest in the business. CME has since dropped its plan for building an exchange with Citadel and now the company is fighting for relevance against ICE's clearinghouse juggernaut. "We view ourselves as very competitive there," says CME Chief Executive Officer Craig Donohue. "There's a lot of time in this game."

The clearinghouse is regulated by the Federal Reserve Bank of New York and the New York State Banking Dept., and the financial reform bill will add oversight from the Securities & Exchange Commission and the U.S. Commodity Futures Trading Commission. "They will find fault, I'm sure, with some of the things we have done," Sprecher says.

If so, it wouldn't be the first time ICE has faced government critics. When oil prices soared to more than $140 a barrel in 2008, some members of Congress blamed speculators trading on ICE for the jump, according to lawmakers' comments and letters to regulators at the time. "It's time to melt away the idea that ICE is a foreign board of trade and instead shine some bright light into this dark market," Senator Maria Cantwell (D-Wash.) said in a June 2008 statement.

Sprecher responded the following month in a letter to Senator Joe Lieberman, the Connecticut independent: "A minority view seems to have developed that 'excessive speculation' is a primary driver of today's oil prices," he wrote. "This view is misguided, and we are gravely concerned that government intervention with efficiently operating markets will only result in market distortions."

Today, the power of speculators in the CDS market troubles executives such as Bill Zollars, chairman and CEO of Overland Park (Kan.)-based YRC Worldwide, the largest U.S. trucking company. His company nearly fell into bankruptcy in December as Goldman Sachs and others sold credit default swaps that would profit from the company's demise. Zollars says he was shocked to learn that his company "was worth more dead than alive" to certain bondholders who had purchased those swaps on YRC. "It was a strange situation where people are making money if they force the company into bankruptcy and 35,000 jobs disappear. That doesn't sound like the American way," Zollars said. What's more, he says, the lack of transparency on CDS made it difficult to find out who was betting against the company so he could appeal to them for help in a restructuring.

The Teamsters, which represents YRC workers, learned of Goldman's involvement from anonymous tips and e-mails of computer screen shots showing Goldman traders dealing in the YRC swaps. The Teamsters pressured Goldman to stop, and the bank agreed to help YRC restructure outside of bankruptcy, according to Zollars and union officials. (A spokesman for Goldman declined to comment.)

Sprecher agrees credit default swaps can harm specific companies or even countries by betting against their sovereign debt. "Over time we will have more transparency and the SEC will come up with circuit breakers and other things to prevent people from abusing trading practices and creating a run-on-the-bank scenario," Sprecher says. Although the clearinghouse concept would not have prevented a situation like AIG from developing–"the instruments AIG wrote were highly customized," he says, and "essentially unclearable"–the move by regulators to bolster collateral requirements for CDS traders has reduced the possibility of another firm imperiling the entire financial system.

Although ICE is clearing about $1 trillion of credit default swaps at any given time, most of the CDS market remains uncleared. Alexander Yavorsky, a senior analyst at Moody's Investors Service, says it's hard to estimate how much of the market will become standardized and liquid enough to be cleared. He says more than 50 percent of the CDS market should eventually be eligible.

For now, the close, mutually beneficial relationship between ICE and the banks that trade through its clearinghouse strikes watchdogs as the wrong way to go. Robert Litan, vice-president for research and policy at the Kauffman Foundation and a senior fellow at the Brookings Institution, is concerned that valuable pricing data will not be fully reported, leaving ICE's institutional partners with a huge informational advantage over other traders. He calls ICE Trust "a derivatives dealers' club" in which members make money at the expense of nonmembers.

Darrell Duffie, a finance professor at Stanford University who co-authored a report in January with the New York Fed on derivatives, raises similar concerns. "We already have an oligopoly among these banks in the over-the-counter derivatives market, and this just further extends the oligopoly to clearing."

Sprecher dismisses the idea that he is Wall Street's caddie, noting that ICE monitors the creditworthiness of member banks and can demand additional collateral if circumstances warrant. "We stand up to the dealer banks every day," he says. B

—With Matthew Leising and Shannon Harrington

COURTESY OF THE U.S. GEOLOGICAL SURVEY

Why did Alex Bogusky, the most celebrated adman of his era, turn his back on the business?

MAD MAN

By Susan Berfield

Illustration By Jiro Bevis

On June 30, Alex Bogusky went for a bike ride in the hills outside Boulder, Colo., then made his way downtown to the century-old house-cum-studio he had renovated and dubbed FearLess Cottage. Once inside, he called Miles Nadal, his boss in Toronto, and resigned. Bogusky was 46. *Adweek* had named him creative director of the decade, and the agency he helped build, Crispin Porter + Bogusky, was bringing in more than a billion dollars in billings. He had a dream title of his own making, chief creative insurgent, and a salary close to $2 million.

Bogusky's conversation with Nadal, the owner of CP+B's parent company, MDC Partners, was followed by an e-mail. Bogusky hoped Nadal saw him "as a friend who wants to try something new." He signed it, "Love, Alex." Then Bogusky and his wife, Ana, spent much of the afternoon sitting on their porch contemplating what he had just done.

MDC relied on CP+B for at least one-quarter of its $546 million in revenues last year, and Nadal often referred to Bogusky as the Steve Jobs of the industry. In a lengthy statement to *Bloomberg Businessweek*, MDC concluded: "Our future has never looked brighter and neither has Alex's." MDC would not grant an interview to discuss exactly how bright its future would be without the most famous name in advertising.

Bogusky declined to comment for this story, too, though he left plenty of clues about his state of mind,


I'M A PC
the 9 inch "Diet"
BYE BYE CP+B

as revealed in interviews with industry peers, co-workers, and family members. There are also hints about why clients, such as Best Buy, Burger King, Domino's, Microsoft, and Kraft, which had just awarded its Macaroni & Cheese account to CP+B, did not want to say much about him. Perhaps the most telling of Bogusky's statements before resigning was a blog post calling for a ban on advertising to kids. In it, he pointed to the child-friendly marketing at Burger King, one of CP+B's biggest accounts. Bogusky had a reputation for pushing clients, employees, and even consumers right to the edge. This time he went over.

Bogusky spent his entire career at one agency, one he had known since he was a child. His father, Bill, was a graphic designer in Miami whose main client was a local firm, Crispin Porter. Bill Bogusky says that at age three Alex drew "an incredibly perfect caricature" of him, which Bill still has in his home studio. As a teenager, though, Alex devoted himself to dirt bike racing and motocross. "I thought the racing was outrageously stupid," says Bill, who nonetheless served as Alex's crew and sponsor. "Then one day he said he wanted to be a graphic artist like me. He sent off his bikes and went to art school in Atlanta." After a semester, Alex returned to Miami and joined the Bogusky studio, where he soon caught Chuck Porter's attention. In 1989, when he was 26, he was invited to join the agency. He was Employee 16. Five years later he became creative director; by 1997, he was a partner.

Crispin Porter was small and unknown to Madison Avenue, but Bogusky and Porter were ambitious, methodical, and ferocious advocates and defenders of their work. (Sam Crispin retired in 1991.) The agency's first big break came in the late 1990s when it put together a series of antismoking ads for teens in Florida funded by the cigarette companies' settlement with the U.S. government. The campaign, called Truth, told kids they were being played by tobacco executives, and the number of young smokers dropped dramatically. Bogusky's creative partner when the campaign went national was Pete Favat, now chief creative officer at Arnold Worldwide. "Alex called us brothers born in outer space who came to earth to screw with the ad world," he says.

Truth won all sorts of industry awards, including a prestigious Effie, which brought all sorts of clients, and employees, to Miami. It also brought Nadal, who in 2001 paid about $20 million in cash and stock for a 49 percent stake in the agency. He now owns it outright.

CP+B's first attention-getting, rule-bending corporate account was the MINI Cooper, which it introduced to Americans with an appropriately minuscule advertising budget. Bogusky put the cars on top of SUVs, in stadium seats, and outside department stores as kids' rides; he produced an online mockumentary about how to spot a counterfeit MINI.

When CP+B won the Burger King account in 2004, America's second-largest burger chain had been trying with scant success to revive the brand. "The guys at CP+B absolutely loved the fact that we were a challenger," says Brian Gies, who was a senior executive in Burger King's marketing department at the time and has since left the company. They conceived of Subservient Chicken, the website that invites viewers to order around a man dressed in a chicken costume. It was one of the first ad sites to go viral, getting more than 15 million hits in the first five days and nearly half a billion since. "We wanted to develop our social currency, to stimulate curiosity," says Gies. "Subservient Chicken was a pretty unexpected but compelling approach to talk about 'Chicken Your Way.'" After that, Bogusky got Burger King executives to reintroduce the King, creepy and silent and hard to ignore. He was just as bold with Volkswagen, persuading the carmaker to run ads featuring a very realistic crash in which no one was hurt. The tagline: "Safe happens."

Bogusky was in total control in the office in Coconut Grove, which was just minutes away from the ocean by skateboard or bike. Bogusky himself might come in on Mondays with a bloody bruise from biking. He was charismatic and intense, good-looking enough to command attention and talented enough to make his unconventional style acceptable. For years, he checked every piece of work. His opinions were orders, and when he reviewed a campaign, the veterans knew to take notes. "He wasn't trying to be an asshole. If you were secure, you would have no trouble," says Evan Fry, a creative director who left CP+B last fall to start his own shop. A sign on Bogusky's door read, "If you want someone to make you happy, see your therapist. If you want someone to make your ads better, see me."

As the agency grew to nearly a thousand employees and won award after award, Bogusky became a somewhat reluctant icon for an industry going through tumultuous times. In 2006, Bogusky and his wife, whom he had met at the agency, decided they wanted to raise their two kids in the progressive city of Boulder. He threatened to quit if not allowed to open an office there. Later that year he took about 50 members of the creative team with him to Boulder. Before long, some 550 people had relocated.

Then something changed for Bogusky. In early 2008 he began to disengage, giving

Bogusky's Greatest Hits



Microsoft took on Mac with "I'm a PC" (2008)



CP+B introduced the MINI Cooper to the U.S. (2001)*



An early effort kept teens from smoking (1998)



Subservient Chicken went viral for Burger King (2004)



"Safe happens," for Volkswagen (2006)

*ALL YEARS ARE LAUNCH DATES

A sign on Bogusky's door read: "If you want someone to make you happy, see your therapist. If you want someone to make your ads better, see me"

up day-to-day responsibilities but keeping an eye on the creative work. While CP+B was making ads about "Whopper freakouts" and perfecting ways to order Domino's pizzas from a laptop on a couch, Bogusky was finishing a book, which he released in the winter of 2008, *The 9-Inch "Diet": Exposing the Big Conspiracy in America*. The back cover promises: "The best tricksters in the industry explain how you as a consumer are being duped and how you are actually part of the conspiracy to make you fat." Many assumed it was satire or even an elaborate advertisement. It was neither. The nine inches of the title refer to the average diameter of a dinner plate in America in 1970; today the size is one-third larger.

Bogusky hadn't told any clients, or Nadal, that he was writing a book. "Burger King and other clients didn't ever figure into our discussions," says Daniel Power, whose powerHouse Books published it. "His idea was: 'We have obligations to our clients, but we can be active agents in the world. Some things we do for a living, and some things have to be challenged.'" In a 2008 interview with *BusinessWeek*, Bogusky called the disconnect between his book and his Burger King work "maybe a bit of creative tension." Fry, who worked closely with him, says Bogusky "had to do some damage control." Burger King declined to comment.

Bogusky continued to move further away from the corporate hand that had been feeding him. He became interested in climate change. He read about the industrialization of food, the politicization of education. He invested in a Boulder company, Justin's Nut Butter, that makes organic peanut butter sold in jars and single-serve packs. The first time he met Bogusky, founder Justin Gold recalls the adman asking him, "Doesn't it suck that you have this amazing organic product in this totally unsustainable package?" Says Gold: "It was the thing you don't want to talk about. He went right for it."

By the end of 2009, Bogusky was ready to leave CP+B, but Nadal wasn't ready to let him go. According to a person familiar with the matter, Nadal offered him a three-year contract potentially worth $20 million. Bogusky wasn't interested. Eventually they worked out an agreement: Bogusky would take one step further back from the agency and become the part-time chief creative insurgent at MDC. Nadal declined to comment.

On Jan. 7, Bogusky called Colin Drummond, then head of account planning at CP+B, into his office to tell him the news. "I was shocked," recalls Drummond. "Alex was pretty matter-of-fact. He wasn't emotional. I knew of his desire to look beyond advertising. He thinks about something for a long time, but he keeps quiet. Then when he makes a decision, he acts very swiftly." They talked about what Bogusky might do next, which seemed wide open and didn't have much to do with MDC. Except in this way, says Drummond: "He said that he told Miles to fire him if he said anything that would potentially upset any MDC clients."

The next morning the seven CP+B partners held a town hall meeting in Boulder. "Alex didn't say he was leaving the agency quite as directly as he did with me," recalls Drummond. "He smoothed it over, saying that he would still have an office at CP+B. He wanted the clients and employees to feel that it wasn't a big deal, and the industry too."

Bogusky continued to influence life at CP+B, though not necessarily in commercial ways. He got the agency involved in a bike-sharing program in Denver and brought in a Buddhist to lead mindfulness sessions. The dissonance between his avocation and his vocation was increasing. When he spoke at a gathering of environmentalists in California in April, Bogusky opened: "Many of us are in this imperfect situation where we make decisions within corporations and then we go outside and have to deal with it." That month he also received at least $10 million for his remaining stake in CP+B.

By June it was clear Bogusky wasn't just leaving the industry, he was turning on it. While most of his peers were at the annual Cannes Lions International Advertising Festival, he was advocating on his blog for a ban on advertising to kids. He named names, citing McDonald's and Burger King, still a CP+B client. Then he sent the post by e-mail to Porter in Cannes. Porter has spoken about Bogusky and the piece just once, to *Advertising Age*: "I told him it was well written and made some great points, but I also said he needs to make a choice because [it's not compatible with the business we're in]. And the next morning he sent me a note saying, 'I resigned like you recommended.'"

In the days after his resignation, there was among his colleagues a sometimes uneasy recognition of the dilemma Bogusky had found himself in. "He was definitely aware that there would be a conflict when he expressed these thoughts," says Drummond. "He wants to see systems change. Who wouldn't?"

Bogusky's decision leaves CP+B without its Jobs, and the first big test of its ability to cope is likely to be with Bogusky's signature client. Burger King recently appointed a new head of marketing and is fighting with its franchisees, in part over the direction of its advertising. "Miles says the relationship with Burger King is solid, but I don't believe it is completely stable," says Jim Edwards, the former managing editor of *Adweek* who now writes about the ad world for BNET Industries. "If CP+B can stabilize it and sales go up, then all is well. If they lose Burger King, then they've lost their biggest client and their spiritual father. And that's a lot of trouble to be in."

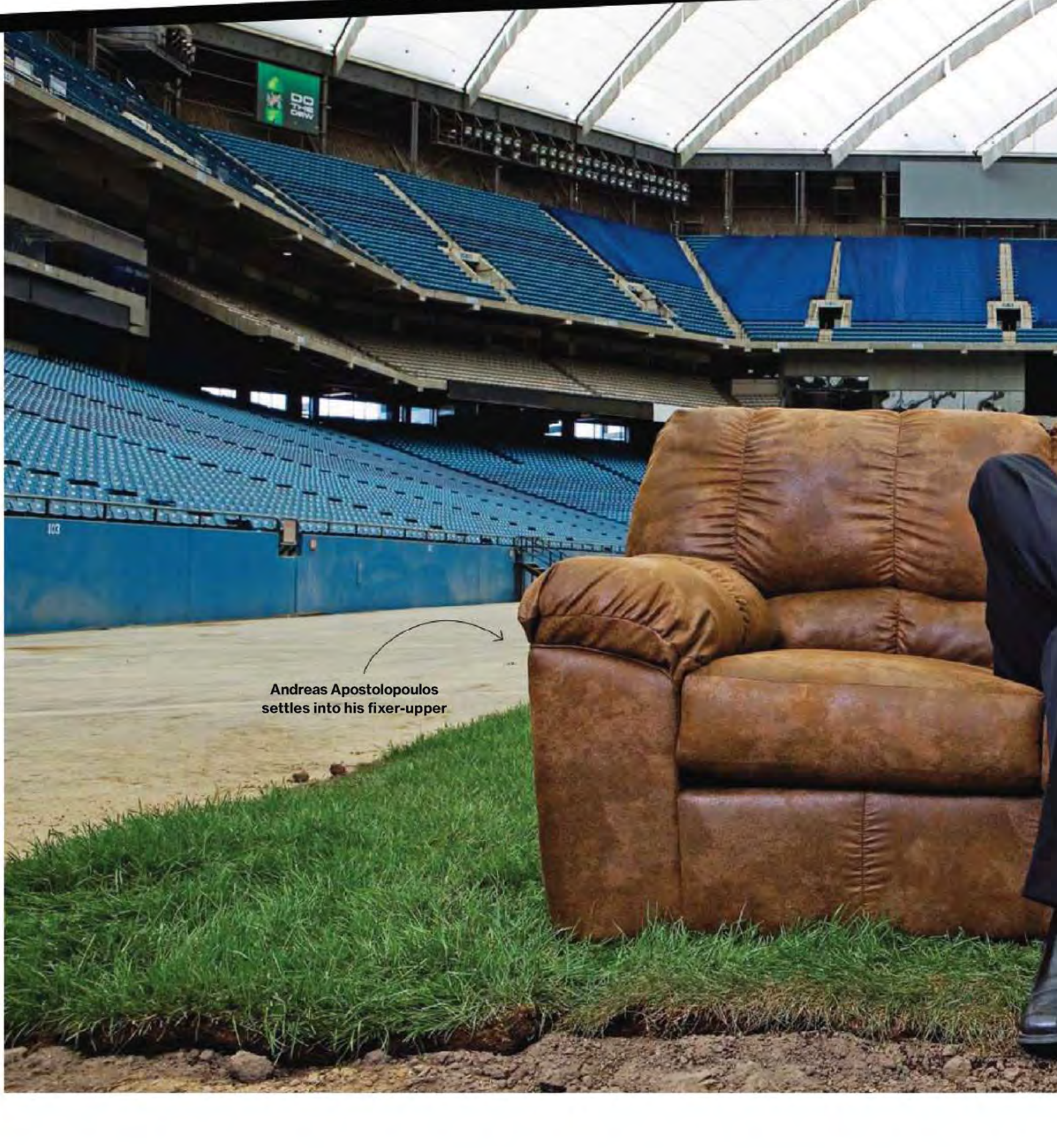
From FearLess Cottage, Bogusky sends out periodic messages to the world, offering glimpses of his future ambitions in sometimes cryptic blog posts and homemade videos. In mid-July he interviewed Robyn O'Brien, author of *The Unhealthy Truth: How Our Food Is Making Us Sick—and What We Can Do About It*, and focused on genetically modified soybeans. "God created all these seeds but never got around to monetizing that s--t. God's a bad capitalist. So we said, let us show you how it's done," he said, to the bemusement of his guest. "We have a right to critique a food system created by a corporation. ... What if things don't turn out well and your kids come to you and ask: 'What did you do to try to stop this?'" Ⓑ



Bogusky in 2009

GABRIELA HASBUN/REDUX

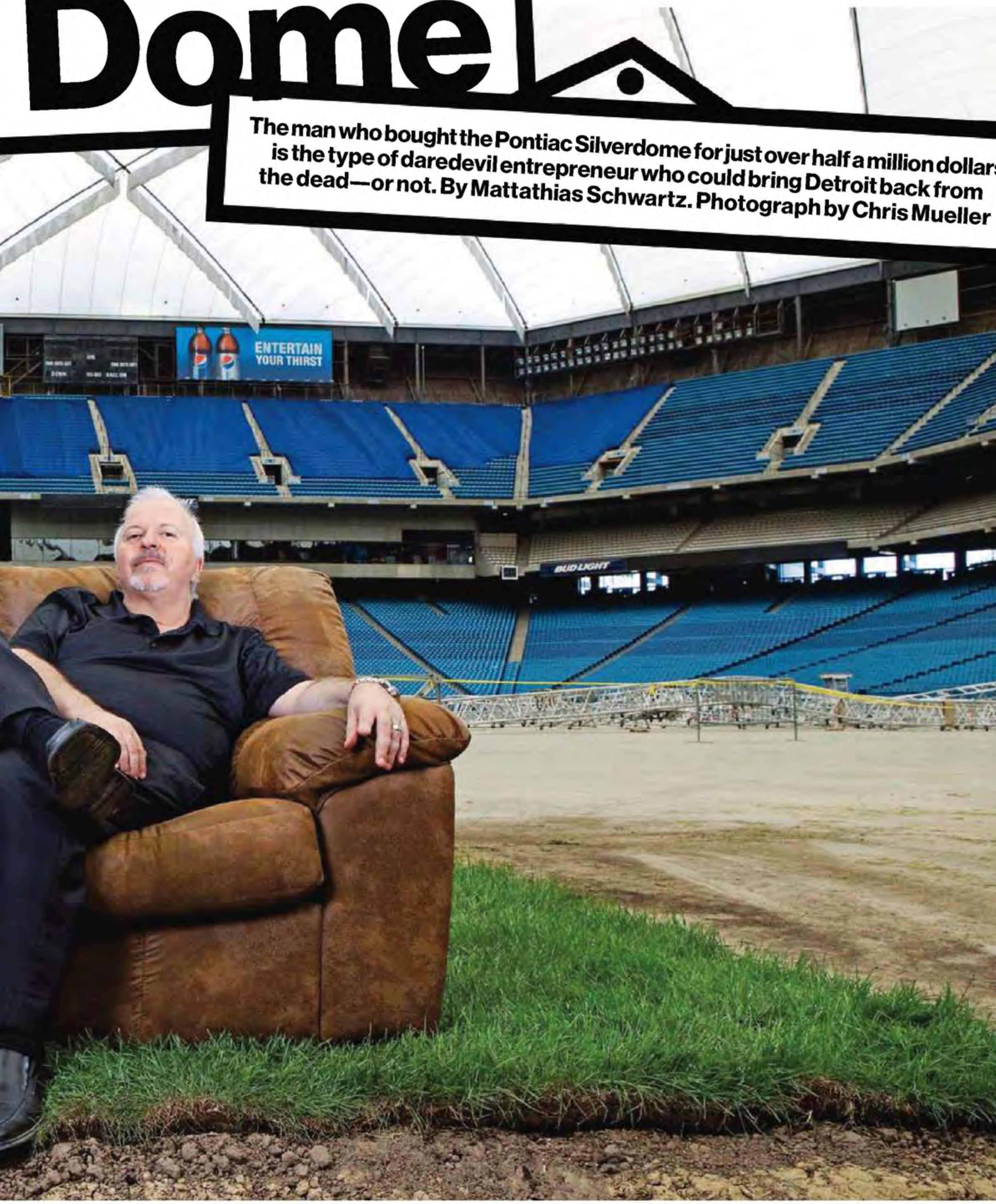
Dome Sweet



Andreas Apostolopoulos settles into his fixer-upper

Dome

The man who bought the Pontiac Silverdome for just over half a million dollars is the type of daredevil entrepreneur who could bring Detroit back from the dead—or not. By Mattathias Schwartz. Photograph by Chris Mueller



Rrring-ring! "Who is this?"

Rrring-ring! "Wrong number!"

Most entrepreneurs would be delighted to discover that a business they acquired included a phone that didn't stop ringing. For Andreas Apostolopoulos, the thrill wore off fast. On Nov. 16, 2009, Apostolopoulos bought the mothballed Pontiac Silverdome for $583,000—about what a four-bedroom suburban house in a non-dying metropolitan area goes for—and soon after calls were flooding in from fans, well-wishers, amateur teams, vendors, promoters, and would-be concessionaires. The sports memories and dormant capitalistic aspirations of the entire Detroit region were flowing through a single line connected to the old beige phone on his desk. The voices, he says, were hungry and intense, and they got on his nerves.

Rrring-ring! "He's not here!"

Rrring-ring! "He's dead!"

The Silverdome is an 80,325-seat stadium plopped down as if from space on 127 cracked acres of asphalt in Pontiac, 30 miles north of Detroit's downtown. Pontiac taxpayers paid $55.7 million to build it in 1975, and in its glory years the dome hosted the Detroit Lions, Pope John Paul II, Elvis Presley, The Who, Led Zeppelin, Super Bowl XVI, and a storied wrestling match between Hulk Hogan and André the Giant.

Apostolopoulos first heard about the availability of the Silverdome while on vacation in his native Greece. One of his three sons saw an ad in the *Toronto Star* announcing that the stadium would be auctioned in three days. The city of Pontiac could no longer afford the facility's $1.5 million annual maintenance bill. Apostolopoulos cut his vacation short and raced home to Toronto. "I thought: Whatever it is, the land alone if I get it at the price I want it, it is worth the money," he says. "And even if inside I don't do anything else, even if I put some small teams of soccer to play, or some football, or some hockey—I said to myself, I sense big opportunity here."

Apostolopoulos, who had never seen the Silverdome in person, placed his bid by telephone from the office of Triple Properties, his Toronto real estate company. He was surprised when his lowball offer prevailed over two other would-be buyers, one of whom wanted to turn the Silverdome into a landfill. Immediately he made it clear to local media that he had no intention of flipping it. He was committed to Pontiac. Amid the region's decline, Apostolopoulos appeared to be a species rarely seen in Detroit and absolutely vital to its future: a bargain-hunter with big dreams.

As you drive north along I-75 from Detroit, the Silverdome's broad white arc appears on the horizon like a Teflon-coated meringue pie. For a time, its crosshatched canvas roof, kept aloft by 25 trailer-sized blowers, made it the largest indoor stadium in the U.S. The Detroit Lions last played there in 2002. A month after his phone bid, Apostolopoulos took possession of the property and was soon spending four days a week in Pontiac, staying at a nearby Marriott and working out of the Silverdome's executive offices.

Despite his purchase of a stadium, Apostolopoulos, 58, projects little vanity or self-regard. He's courtly and soft-spoken, and dresses in a subdued palette of black and gray. His only indulgence since buying the Silverdome was asking the facilities team to wire his office for cable, so he could watch the World Cup at his desk. The desk itself is covered with bank statements, a calculator, and columns of handwritten phone numbers and figures. It used to take dozens of employees to manage the dome. He's pared the number down to six.

Born in the Greek port of Kalamata, Apostolopoulos immigrated to Canada in 1969 with a suitcase, $50, and very little English. His first job was cutting up chickens in the back of a Toronto KFC. After a stint as a janitor, his entrepreneurial nature kicked in and he began soliciting his own janitorial clients, hiring former co-workers to help with the abundance of work. In 1978 he founded Olympic Plastics, a small factory making plastic bags, and soon was dallying in real estate; one of his first deals was the purchase of an empty parcel beside a General Motors plant that seemed poised to expand. He bought it with a partner for $1 million in 1988—and sold it to GM within a year for $3 million. His worldwide empire is now worth $800 million.

Soccer has always been Apostolopoulos' passion—as a boy he wound scraps of cloth into a makeshift ball and played in the streets—and his long-term plan for reviving the Silverdome revolves around the sport. He estimates he'll spend between $2 million and $3 million to stage and promote "Match of the Titans," a game between A.C. Milan and Panathinaikos F.C. scheduled for Aug. 6. Seventeen World Cup players will take the field. Apostolopoulos refuses to deal with ticket brokers and their convenience fees. "We can have our own Ticketmaster," he says. Tickets, sold on the Web and at the Silverdome box office, range from $29.95 to $150. If attendance is on par with "Domination in the Dome," an April monster truck rally that drew 24,000, Apostolopoulos says he'll cover his costs.

Over the next few years, Apostolopoulos hopes that a series of world-class exhibition games at the Silver-

> **Apostolopoulos cut short a vacation in Greece to race home and bid on an 80,000-seat stadium he'd never seen. One rival for the Silverdome had plans to turn it into a landfill site**



Silverdome Super Bowl: The 49ers beat the Bengals in Detroit in 1982

dome could pave the way for a new Major League Soccer franchise. One significant problem is that the Silverdome is much too large for professional soccer. The new MLS model is Red Bull Arena in Harrison, N.J., which holds just 25,000. So Apostolopoulos is considering slicing the stadium into two tiers–putting in a floor where the upper deck starts to create an MLS-sized facility with natural grass (the dome does let some sunlight through) and using the space beneath it for basketball, hockey, and concerts.

"Detroit has lacked someone with the combination of financial resources and a passion for soccer," says Roger Faulkner, who led Detroit's successful bid to host four World Cup games in 1994, and who Apostolopoulos has brought on as an adviser. "The Apostolopoulos family has both. That gives us the nucleus."

In the past, Apostolopoulos has specialized in renovating vacant industrial properties and filling them with tenants. He's confident he can transfer that skill to the business of filling stadium seats. "There are always a lot of surprises," he says. "I'm still learning." Apostolopoulos is taking the value-oriented approach that served him well in real estate and applying it to the more glamorous process of turning himself into a soccer mogul. "Most rich guys buy teams," says Silverdome spokesman John Mozena. "Andreas bought a stadium. Now he's looking for a team."

He'll have to stand in line. Portland, Vancouver, and Montreal already have deals for MLS expansion teams in 2011 and 2012. "There are discussions going on in many markets," says Will Kuhns, a spokesman for Major League Soccer. "Detroit has been among them."

In anticipation, Apostolopoulos is doing what he can to improve the Silverdome's ambience. Contractors have used more than 10,000 gallons of paint to brighten the place and 12 miles of cable to upgrade its infrastructure. New suede couches, still wrapped and tagged, wait outside the doors of 90 club-level suites. Plumbers have repaired pipes on more than 500 toilets and urinals, which froze, he says, when Pontiac was too destitute to heat the Silverdome during the winter. Apostolopoulos estimates that he's already spent $3 million on renovations; once the building is restored to his standards, he expects annual maintenance costs to rise to about $5 million a year. He's also banking on a rise in revenues, from $2 million in 2010 to $10 million next year.

Detroit has touted its recovery almost as long as it's been in crisis. Yet the Silverdome's second life could be part of a genuine rebound, albeit one that requires more than the usual qualifications about green shoots and fickle economies. At TechTown, a former auto plant now run as a small business incubator by Wayne State University, more than 150 startups have taken root inside a 12-block research park. The Russell Industrial Center, a 2.2 million square-foot former factory that sold for $1.5 million in 2002, now rents to about 160 artists and businesses. Detroit is the 11th-largest metro area by population, but a survey by the Brookings Institution's Metropolitan Policy Program ranks it ninth in total exports and fifth in export-related jobs.

Over the past 12 months the median home sale price rose from $6,500 to $9,900 in the city of Detroit, and from $56,000 to $79,225 throughout the region. Even the Silverdome's neighbors are showing signs of stirring. In one vibrant office park, dozens of Hewlett-Packard workers take a smoke break; nearby, Raleigh Studios has broken ground on an $80 million sound stage facility. Three thousand jobs are expected.

Still, 3 million sq. ft. of factory floor sit vacant at the Pontiac Assembly Center, where rusted steel signs designate reserved parking spaces for the Quality Operations Manager, Material Superintendent, and other obsolete jobs. The future of such ghostly spaces depends on Detroit's ability to attract outside investment. The price of property is becoming an attraction for patient investors, says A.J. Weiner, a senior vice-president at Jones Lang LaSalle. "People are looking at these properties on a price-per-pound basis, not a return basis," says Weiner, who specializes in commercial leasing and sales. They're saying, 'I'm going to buy it cheap, for cash, on the strict value of the building or the land, at a tremendous discount. If the economy comes back I'll be able to fill it up or flip it.'"

Apostolopoulos maintains that he wants to fill, not flip, the Silverdome. He's endured some mishaps. In May an outside promoter cancelled a much-hyped series of soccer matches between national teams from Ghana, Kenya, Malaysia, and Puerto Rico. In June another promoter's stage collapsed, injuring 11 workers and forcing the postponement of a concert featuring the Indian composer A.R. Rahman.

The Silverdome remains a powerful brand in Detroit, and a good piece of the value that Andreas acquired was the name. The current bookings reflect an omnivorous appetite for revenue. In the coming months the stadium will host a motorcycle rally, a home show, a Hollywood film shoot, and a medical marijuana expo. Apostolopoulos has been renting the field to outside promoters for as little as $20,000 a day. An electronic sign facing Route 59 is renting for $5,000 a week. The vast parking lot rents for drive-in movies, pop-up auto dealerships, keyless car-lock demos, and truck driving schools. Business may not be booming, but there is business. And fortunately for Apostolopoulos, the main phone line doesn't ring on his desk anymore. In fact, the old phone has been put away in a box of Silverdome relics, and when he answers his new one, he no longer claims to be dead. Ⓑ

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Etc.

What's fueling the growing geekonomy... Page 72





The Money Shot Investment

Is $200,000 too much for a rifle? Apparently not for some moguls. Peter Hofer's bespoke arms business is thriving. *By Paul M. Barrett*

Photograph by Thibault Montamat

TOP: PHOTOGRAPH BY PLAMEN PETKOV FOR BLOOMBERG BUSINESSWEEK

Etc. Guns

A snarling white jaguar guards the door of the wood-paneled Austrian atelier of Peter Hofer, one of the world's last super-high-end gunmakers. Now stuffed, the cat was a casualty of the sort of exotic hunting expedition for which Hofer creates unique firearms.

You don't buy a Hofer to plink beer cans. His clients include Persian Gulf princes and Russian oligarchs for whom a couple hundred thousand dollars is a reasonable price for an exclusive toy. Many of his creations seem too exquisite for actual use. Hofer wears white gloves to reduce corrosion from perspiration when he presents the Hummingbird, a side-by-side double rifle chambered for tiny .17 caliber rounds. Forty gold-and-enamel birds flit against a lush backdrop of engraved-steel wildflowers. The gleaming walnut burl stock was sculpted from an 800-year-old Turkish tree. It's weight: 0.9 kilograms, about the heft of a ripe pineapple.

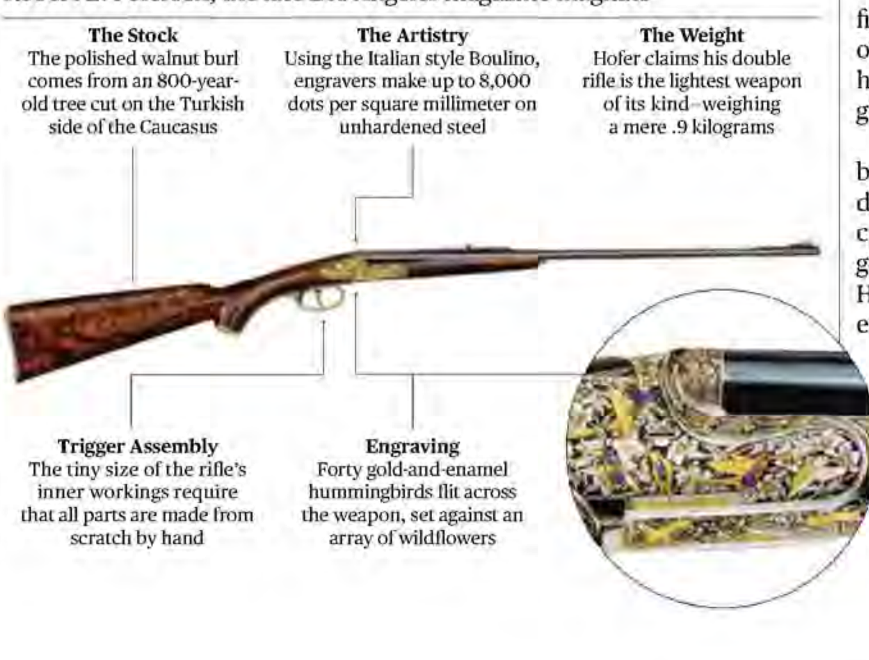
"The problem is not in bigger and bigger," Hofer explains. "The problem is in smaller and smaller." Reducing the trigger assembly and springs to Lilliputian dimensions requires metal-working dexterity approaching that of surgeons. After I mistakenly handle the Hummingbird ungloved, an assistant briskly materializes to massage it with protective oil.

Hofer, 50, enjoys demigod status among gun enthusiasts. His wild Beethoven hair complements a Mitteleuropean accent and gesticulation worthy of a symphony conductor. His outfit combines a forest-green Austrian outdoorsman's jacket with neatly pressed Polo Ralph Lauren blue jeans.

Hofer's fancy firearms begin at $200,000. He once spent tens of thousands of hours on one rifle

Firepower or Collector's Item?

Hofer originally designed the Hummingbird rifle (below) for Robert E. Petersen, the late Los Angeles magazine magnate



Most of his sales result from individual commissions; customers hear about him by word of mouth. Some clients trek to his workshop in a converted château next to a church in Ferlach, a village so tiny it doesn't even have its own train station. "He is among the most elite of the elite: gunmakers whose work is really closer to art and can be afforded by only the wealthiest hunters and collectors," says Gavin Gardiner, a sporting-arms auctioneer in London.

The greater gun industry is in a period of consolidation. The largest U.S. firearm and ammunition manufacturer for the mass market, Freedom Group, is a conglomeration of companies pieced together over several years by the New York investment firm Cerberus Capital Management. The bespoke business is also following this pattern. Some craftsmen in Ferlach, London, and other centers of custom gunmaking are suffering. Yet Hofer is going strong. His products are so expensive and his customers so flush that his business enjoys the rarefied position of being immune to the economy. He also offers moguls something many seek when it comes to their gun collections: anonymity. Unlike Gulfstreams, fancy firearms are a form of conspicuous consumption that the rich paradoxically keep private, in part out of concern that some in polite society view the hobby as, well, nuts.

If attention deficit disorder is the emblematic malady of the early twenty-first century, Hofer happily suffers from something like the opposite: inordinate concentration syndrome. He designed the original version of the Hummingbird model for Robert E. Petersen, the Los Angeles specialty-magazine magnate who started *Hot Rod*, *Motor Trend*, *Guns & Ammo*, and a slew of other titles. Petersen died in 2007 at the age of 80; his family has several Hofer creations in one of the finest private firearm collections in the U.S. "He thought the world of those Hofer guns," says Ken Elliott, a friend and business associate. "Some people want to have the very best of what they love. Bob loved guns."

Hofer and his eight employees labor on only 20 firearms at a time. They once spent tens of thousands of hours over a dozen years on a double-barrel rifle, he says. "This was a fantastic rifle. It's really hard to give away, because there is so much feeling in it."

He doesn't exactly give them away. Hofer's prices begin at $200,000 and can exceed half a million, depending on the technical complexity and delicacy of the engraving. "They're pure whimsy, so staggeringly intricate it's hard to believe," says Stephen Hornady, president of the U.S. ammunition producer Hornady Manufacturing.

Artisans have built weapons in Ferlach, just north of the Slovenian border, since the 1550s. Back then, Ferdinand I, Emperor of the Holy Roman Empire, paid Belgian craftsmen to form a guild and take advantage of Ferlach's iron deposits and water supply. Ferdinand worried about more than shooting deer; he needed to stave off




Alfred Zeiner at work on a Hofer rifle; hunting trophies at a Ferlach museum.

PHOTOGRAPHS BY THIBAULT MONTAMAT FOR BLOOMBERG BUSINESSWEEK

the Ottoman Empire. The guild, whose history is chronicled in the village museum, founded its own school in Ferlach, which exists to this day. Hofer's father, a gun dealer, sent his boy to the institute, from which Peter graduated in 1979.

After laboring as an apprentice, Hofer started his own business in Ferlach in 1986, convinced there would be a market for even bolder designs than the guild traditionally attempted. In addition to his workshop aides, he employs four engravers who operate out of home studios where they can concentrate on making up to 8,000 dots per square millimeter on unhardened steel. Using 40-power binocular microscopes, the engravers follow an Italian style known as Boulino. Hofer suggests the imagery: His gun side-locks are decorated with everything from bare-breasted Dianas to scenes from a Rubens painting of a hippopotamus hunt. Warthog, bear, stag, lion, and oryx make appearances, often in mortal conflict. Sentimental clients ask Hofer for family portraits with their wives and children.

Hofer's assistants occupy a warren of work spaces behind the showroom. In one, white-haired Alfred Zeiner carves a walnut stock nestled in a wood-lined vise as Mozart plays on an old radio. In an adjacent room, Andreas Smuck, wrapped in a green apron, consults with Hofer about a rifled third barrel they are adding to a shotgun.

Sentimental clients ask Hofer to engrave family portraits on their rifles

"Like art, this is an investment," Hofer says. "This is not like the houses in America–what you call it, subprime? Every year the price does go higher." Because of the small supply and the cult-like devotion of collectors, the best Ferlach weapons tend to appreciate in value, making them a sound acquisition for those with the cash, confirms Gardiner, who handles the discreet resale of expensive weapons.

Still, the Ferlach guild has dwindled to only 11 independent shops. Hofer has done his part for continuity, marrying Daniela Fanzoj, whose family has made guns in Ferlach for 300 years. Lisa, Hofer's 20-year-old daughter, obtained a degree in industrial design from the Ferlach institute this June. Her father hopes she and her three siblings will one day take over the business: "I want to see this tradition survive."

During my stay, Hofer invites me to try a bolt-action rifle decorated with gold-accented antelope and zebra cavorting through an African dreamscape. Chambered for .270 Winchester Short Magnum rounds, the gun ought to have a potent kick. I squeeze the trigger. *Bam*. To my surprise, the recoil feels friendly, even gentle. Then again, for this kind of money, a firearm should be polite. B



The USB Webcam Rocket Launcher ($49) lets you control your buddy's webcam and shoot him.

For $5.99, the site says, **Baconnaise** exemplifies the "glorious union between bacon and mayonnaise."





The Bluetooth Retro Handset ($29.99) lets you talk in style.





AntWorks ($39.99) is, according to ThinkGeek, a Space Age ant habitat.



The Electronic Rock Guitar Shirt ($29.99) lets you strum as you wear. Also available in kid sizes.

The Rise of Geek Chic

ThinkGeek.com is growing, and nerd connoisseur Ty Liotta is leading the way. *By Ronald Grover*

Ty Liotta isn't just any overgrown nerd. He's the ultimate arbiter of geek taste—the Anna Wintour of the pocket-protector set. As senior merchandiser for the e-commerce site ThinkGeek.com, Liotta, 39, is responsible for discovering and creating such must-haves for geeks as a T-shirt that sniffs out Wi-Fi hotspots and the Tauntaun sleeping bag, modeled after the animal carcass that saved Luke Skywalker from certain death on the frozen planet of Hoth.

Against a backdrop of shrinking U.S. retail sales, the geekonomy is fast expanding. Fueled by the success of items such as zombie dolls and spy cams, Fairfax (Va.)-based ThinkGeek's sales grew 57 percent in the first quarter of 2010. Analyst Jon R. Hickman of MDB Capital Group expects sales to surpass $64 million this year—up from $49 million in 2009. Hickman rates parent company Geeknet a buy.

Rival X-TremeGeek.com is also enjoying a bump, says Tim Burns, head of that site's consumer operations. In an age when an iPhone antenna is front-page news, many expect sales to keep rising. "Steve Jobs has made geeks cool," says James L. McQuivey, an analyst with Forrester Research, who once programmed his own computer. "Knowing about hot new technology has become as much a status symbol as owning a Lexus."

After launching in 1995 as an online T-shirt retailer called WizardNet.com, ThinkGeek has evolved into a full-service destination for all things nerd. Liotta heads a five-person "Geek Lab" charged with discovering products that will incite geek pandemonium. It buys some, such as electronics, and contracts out its other tchotchke-based ideas, such as a Wi-Fi-detecting T-shirt, to Chinese manufacturers. Liotta holds court in an office cluttered with Super Mario Bros. figures, an R2-D2 trash can, and collectible *Star Trek* action figures. A large Millennium Falcon, resembling the one flown by Han Solo, hangs overhead. A prototype of a night-vision camera sits on a counter.

"We're all geeks around here," says Liotta, whose father used to build robots

Liotta in his "Geek Lab" with fellow tastemakers at ThinkGeek.com. The site is expected to rack up more than $64 million in sales this year.





The Grassy Lawn Charging Station ($24.99) allows gadgets "to think they're on a charging vacation."



Blood Caffeinated Energy Potion ($4.99) looks and feels like the real stuff.



The WiFi Detector Shirt ($29.99) has a built-in signal finder that's "perfect for nomads with laptops."



The Rovio WiFi Roaming Bot ($229.99) is a mobile wireless spy cam.



The USB Lightsaber Lamp ($25.99) is popular with the site's *Star Wars* fans.

PRODUCT PHOTOGRAPHS BY PLAMEN PETKOV FOR BLOOMBERG BUSINESSWEEK; OFFICE PHOTOGRAPH BY ANDREW CUTRARO FOR BLOOMBERG BUSINESSWEEK

in the basement. "We figure that if we like it, it's going to sell." The company's top sellers follow certain themes: They are either goofy products that do weird things (such as a T-shirt that plays songs), goofy products that serve some function (like a Bluetooth earpiece in the form of a retro telephone), or anything having to do with *Star Wars* or *Star Trek*.

Proving one's geek bona fides isn't easy: There's hazing involved. The first question of a new applicant's interview invariably is, Liotta says, "How geeky are you?" He adds: "And you have to back it up. If you say you like *Battlestar Galactica*, someone is going to make sure."

Approximately 3 million people log on to ThinkGeek.com every month, the company says, with buyers plunking down $56 apiece on average. More expensive items include the $119.99 *Star Wars* light sabers with sound effects recorded from the George Lucas blockbusters, or a $349.99 gizmo that converts an iPhone into a movie projector. "What we don't do is golf," says Liotta. "Geeks are definitely anti-golf."

"We've tapped into the inner geek of a lot of people," explains Scott L. Kauffman, chief executive of Geeknet. ThinkGeek remains the company's growth engine. The site's traffic soared when the stars of the CBS sitcom *The Big Bang Theory* donned ThinkGeek T-shirts displaying the molecule for caffeine.

In May the company paid $1 million for Geek.com, a news and review site from which it hopes to direct more traffic to ThinkGeek. (Geeknet also operates the advertiser-supported SourceForge.net site that provides free open-source software.) Liotta's crew now makes regular appearances at geek gatherings around the country. A team headed to the comic book industry's flagship event, Comic-Con International, in San Diego on July 22-25 in search of emerging trends. "To some people, we're rock stars," Liotta says–right up there with actual famous people, like Angelina Jolie, who also appeared at Comic-Con to promote her new movie, *Salt*. In August, Liotta will head to Orlando for the Super Bowl of geekdom, the annual *Star Wars* convention.

Earlier this summer, ThinkGeek received an unexpected boost when the National Pork Board filed a cease-and-desist order after the site staged an April Fool's promotion through the sale of "Unicorn meat," which they dubbed "the new white meat." The tussle received national attention. To capitalize on the moment, Liotta says ThinkGeek is busily planning a can of *faux* unicorn meat for purchase on its site. B

The Beach Read

"Wittier than Dorothy Parker, dissects the rich better than F. Scott Fitzgerald," claimed a rave in *The New York Times Book Review*

Beyond Dan Brown: Backlist pleasures for your blanket

The Want: A trusty paperback that's highbrow—and salacious. It can't have been made into a blockbuster, shouldn't be on every towel, and should have modern-day resonance for dinner-table chat. Bonus points for a love story that's a page-turner.

The Get: *The Locusts Have No King* (Steerforth Press, $14), by Dawn Powell. After decades of obscurity, Powell's many charms have recently awakened readers. The 1948 tale of a scholar's roller-coaster affair with a married society type is an anguished love story, a reversal-of-fortune parable, and a blistering satire that rings true today—cynical columnists, silly socialites, sinister nighthawks, all in one gorgeous Deco package. —*Boris Kachka*



All of Powell's books were out of print when she died in 1965. They were reprinted in the mid-'90s

BEACH BOOK BONANZA

A summer read in every genre



The Summer Hook-up

One Day, by David Nicholls (Hodder & Stoughton) Will-they-or-won't-they gets a new twist at the hands of this witty British writer, whose novel checks in on platonic friends on the day they hook up—and on that same day every year thereafter.



The Sexy Classic

The Garden Of Eden, by Ernest Hemingway (Scribner) Bone up on the canon with Papa's least-known novel: No macho theatrics, just a sexy and volatile threesome in the French countryside.



The Business Potboiler

Indecent Exposure, by David McClintick (Harper Paperbacks) In one of the first (1982) high-finance page-turners, McClintick follows one forged check that began a power struggle at Columbia Pictures. Crime, glamour—and every word is true.



The Sports Bio

A Sense Of Where You Are, by John McPhee (Farrar, Straus & Giroux) The perfect antidote to LeBron hoopla is this 1965 bio of the modest, brainy basketballer Bill Bradley, when he was a Princeton senior—as filtered through McPhee's crisp, vivid writing.

TOP: PHOTOGRAPH BY JAMIE CHUNG FOR BLOOMBERG BUSINESSWEEK

Last year 14 billion coffee lids were sold in the U.S. The lid market is valued at $180 million

Traveler is in MoMA's design collection

The updated Traveler has a sliding closure

Plug-hole technology is a pioneering trend



Letica is one of Solo's main rivals in the lid business

The Big Top Circus

The coffee lid business is booming. And it's getting weird.

By Benjamin Wallace

Another must-have soldier accessory must now be added to Camelback canteens: disposable French press coffee lids. "A lot of deployed servicemen were e-mailing me, 'We're trying to get a good cup of coffee off the hood of a Humvee,'" says Forrest Graves, a roaster in Cleveland, Ga. Graves knew just what to send them—the Xpress Lid. Made by SmartCup, the Xpress Lid incorporates a plastic strainer and plunger that transforms humdrum paper cups into disposable, single-use plunger pots. SmartCup sells to specialty shops and java enthusiasts for about 40¢ each. The lids are already making inroads in the Middle East. "We started shipping it to troops," Graves says.

We are living in the golden age of coffee lid design. The breakthrough lid, Solo Cup's Traveler model, made its debut in 1986 and is now part of the Museum of Modern Art's permanent design collection. "Initially the Traveler lids were a tough sell, on account of its higher price," says Solo spokeswoman Louise Beyer. Then Starbucks picked it as their go-to lid, and the rest is history. The coffee lid market is valued at roughly $180 million, according to a recent study by Chicago research company Technomic. Last year 14 billion lids were sold in the U.S. alone.

The Xpress Lid, made by SmartCup, transforms your paper cup into a pot of French press coffee for about 40¢



Despite the prominence of the Traveler, designers keep coming up with more elaborate versions. New York-based architect Louise Harpman has what may be the largest collection of independently patented "drink-through plastic cup lids" in the U.S.—132 and counting. She recently acquired a lid that harnesses steam to warm chicken and biscuits placed on top of it. "That's where it's going," Harpman says: "Lid-cup stratification assemblies." Or something like that.

A Syracuse student has developed a "caddy" lid with slots for creamers and sugar. Another concept, Coollid, features a built-in reservoir which cools a mouthful of coffee by separating it from the rest of the chamber. One recently patented lid uses NASA-derived shape memory material, which unplugs the drinking hole when the coffee reaches a palatable temperature. Australian company Smart Lid Systems has designed a lid that changes color when coffee cools. Says Technomic's Joe Pawlak, "This is not something I saw 10 years ago." B

TOP: PHOTOGRAPH BY JAMIE CHUNG FOR BLOOMBERG BUSINESSWEEK

Etc. Navigator

Under-the-Radar Rentals

Skip obvious weekend retreats for something more secluded—and still within four hours of downtown



Round Barn Winery offers tastings of its own wine, beer, and vodka

Chicago: **Sawyer, Mich.**

Travel time: 2 hrs.

Chicagoans have escaped to the eastern shores of Lake Michigan for ages. Yet few venture to the Sawyer area, which boasts three miles of shoreline backed by wildflower-strewn dunes and elm forests. **Cottage at the Dunes** is a three-bedroom jewel with a wood-burning stove, quaint cottage decor, and proximity to Warren Dunes State Park's 240-foot sand banks ($1,700 per week). Drive 20 minutes east and you're in Michigan wine country. **Round Barn Winery** produces several worthwhile whites and fruit brandy. Nearby **Lemon Creek** is known for its dry reds.

Atlanta: **Asheville, N.C.**

Travel time: 3 hrs.



Nestled in the Blue Ridge Mountains, Asheville balances boho culture and Appalachian tradition—and it's less trafficked than antebellum Savannah, Ga. Rent **Rainbow Ridge,** a two-bedroom cabin with a hot tub and sunset views. It's 15 minutes from town but still woodsy and remote ($578 for three days). The **Biltmore Estate,** a museum and 8,000-acre park (day pass, $60), is a glimpse at the town's Gilded Age glory. At night, locals bring fiddles to **Jack of The Woods** for impromptu jam sessions; others hit **The Orange Peel,** ranked by *Rolling Stone* as one of the coolest live music venues in the U.S.



Dallas: **Bend, Tex.**

Travel time: 4 hrs.

The rough-and-tumble antidote to Dallas, **Colorado Bend State Park** has a deep canyon rimmed with limestone bluffs and a fertile floodplain of lush groves. Canoe downstream to Lake Buchanan, hike 60-foot Gorman Falls, or take a ranger-led caving trip. Stay at rustic **Sulphur Springs Camp,** which has a spring-fed swimming hole and five air-conditioned cabins with cliff views ($69 per night). Each has a barbeque pit, but the nearby **Cooper's Old Time Pit Bar-B-Que** (a Dubya favorite) is famed for mesquite-smoked brisket and pork ribs (Bush's pick).





Colorado Bend State Park's 5,328 acres contain a lake, river, waterfall, and 150 wild caves

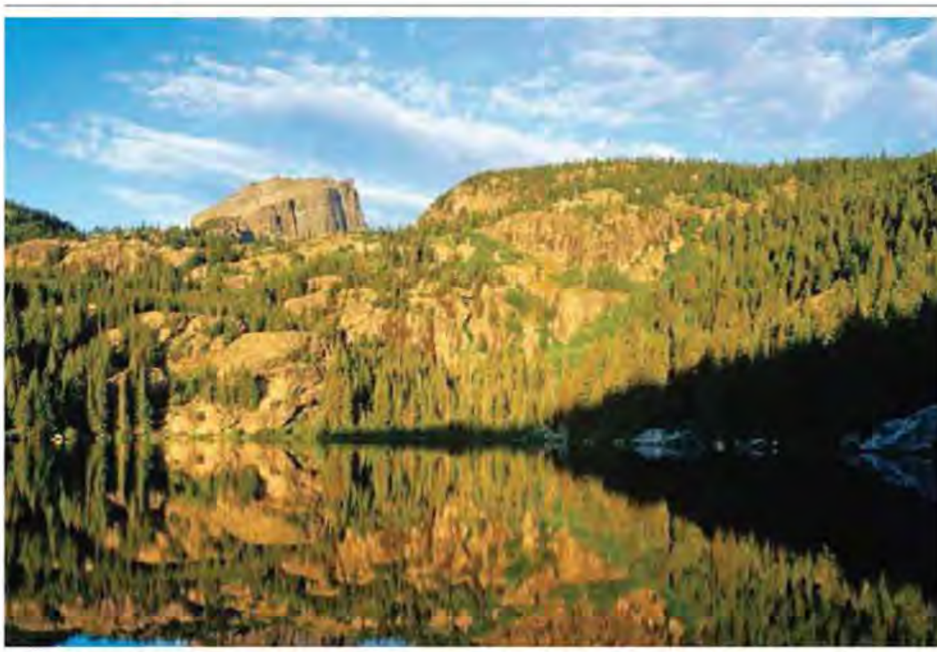
San Juan Island's whale-watching season lasts from mid-April to mid-October

Seattle:
San Juan Island, Wash.

Travel time: 2 hrs.

It's easy to find a place to paddle along the Puget Sound, but the most impressive experience is off San Juan Island's west coast, where some 80 orcas prowl the waters during salmon season each summer. If money is no object, book the stunning, three-bedroom **Seas the Day,** a rental perched on a rock above the Haro Straits ($990 per night, $225 cleaning fee). Paddle through crowds of killer whales—don't worry, they're only after the salmon—on a one-day sea kayak trip with **Outdoor Odysseys** ($95 per person). Later, venture into town for applewood-smoked oysters at **Duck Soup Inn.**





Denver:
Grand Lake, Colo.

Driving time: 2 hrs.

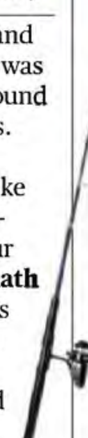
The best jumping-off point for exploring Rocky Mountain National Park—while avoiding the tourists in Estes Park—is **Bear Crossing,** a secluded three-bedroom cabin on the western banks of Grand Lake. It has a boat dock as well as a jaw-dropping view of Shadow Mountain ($475 per night, two-night minimum). Spend a day or two exploring the alpine tundra atop Flattop Mountain and taking in views of Ptarmigan Glacier with a local guide from **Kaiyote Tours** ($180, full day). When your legs are eventually burned out from all the hiking, rent a Sea-Doo speedboat at **Trail Ridge Marina** ($250 for four hours) and search for osprey; these beautiful hawks fish for rainbow trout in these waters.

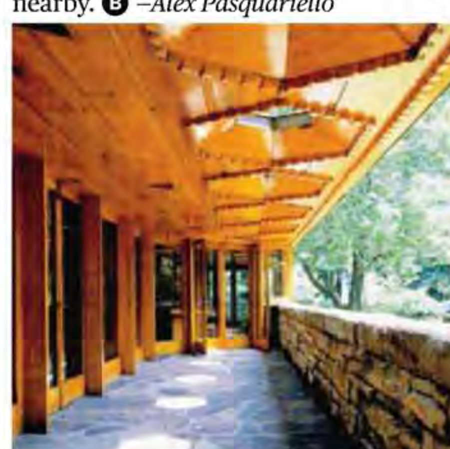


Baltimore; Pittsburgh; Washington, D.C.:
Laurel Highlands, Pa.

Driving time: 4 hrs., 1.5 hrs., and 3.5 hrs., respectively

A patchwork of picturesque forests and country clubs, the Laurel Highlands was once the hunting and fishing playground of Industrial Revolution-era barons. It's now better known for a few of Frank Lloyd Wright's best works, like **Fallingwater** and the cypress-and-sandstone **Kentuck Knob.** Rent your own Wright for a weekend at **Polymath Park Resort:** The 100 acres contains **Duncan House**, a one-story ranch built in 1957 ($425 per night, two-night minimum). Bring your fly rod to fish the teeming trout streams nearby. **B** *—Alex Pasquariello*





VINEYARDS: JIM POWELL ADVERTISING PHOTOGRAPHY/AURORA; FIDDLE: HOWARD KINGSNORTH/GETTY IMAGES; LAKE BUCHANAN: JAMES FORTE/ NATIONAL GEOGRAPHIC STOCK; FLATTOP: ADAM JONES/VISUALS UNLIMITED/CORBIS; FISHING ROD: TIM RIDLEY/GETTY IMAGES

After turning his family's shop into a chain, Lipton spent his final decades chasing the America's Cup



The Original Captain of Industry

Lessons learned from Sir Thomas Lipton, one of the world's first celebrity CEOs. *By Ian McGugan*

The America's Cup exerts a gravitational tug on rich, eccentric overachievers. Ted Turner, Larry Ellison, and Bill Koch are just some of the gazillionaires to compete for the most prestigious trophy in racing. Long before any of them, there was Sir Thomas Lipton—the Great Lipton, as he called himself.

A millionaire grocer and tea baron—yes, that Lipton—the Glaswegian was probably the first businessman who set out to become a celebrity. Other tycoons attained renown before him, but to J.P. Morgan and Cornelius Vanderbilt, celebrity was an annoying byproduct of their business success. For Lipton, fame was a vital part of corporate strategy. Known for publicity stunts such as driving pigs through the street to one of his grocery stores under a banner proclaiming them "Lipton's orphans," or offering slices of what he alleged was the world's biggest cheese, he cut the template for future celebrity CEOs. Michael D'Antonio, author of a new biography, points out that Lipton used fame to sell his tea and groceries. But there's scant evidence, in this book or elsewhere, that a celebrity CEO confers any lasting advantage on a company. Particularly when, as was Lipton's case, the CEO becomes famous for something completely unrelated.

One way to read D'Antonio's book is as a cautionary tale about what happens when a CEO becomes more concerned about fame than the bottom line. Lipton spent the first 30 years of his career building an enormously successful chain of food stores throughout Britain. He then spent much of the next 30 in pursuit of the America's Cup. While he lavished spectacular amounts on his chase, his business eroded.

Lipton doesn't appear to have pondered this problem much. His real passion was himself—or at least the version of himself he presented for public consumption. By the early part of the 20th century the press knew him as a Buckingham Palace intimate, a yachtsman, and a man about town with an eye for the ladies. According to D'Antonio, though, he surreptitiously funded the cause of Irish independence, couldn't have

A Full Cup: Sir Thomas Lipton's Extraordinary Life and His Quest for the America's Cup

by Michael D'Antonio, RIVERHEAD BOOKS; 368 pp, $26.95



TOP: LIBRARY OF CONGRESS

reefed a tops'l to save his life, and was likely gay. (D'Antonio suggests Lipton found love with his housemate, William Love, and other men later in life.)

If Public Lipton was different from Private Lipton, there was good reason. During his lifetime, homosexuality was a criminal offense and business was a social one. Much of the British upper crust sniffed at people who made their fortune rather than inherited it. Lipton led a life of regal splendor, swanning between his London estate and his massive plantation in Ceylon (now Sri Lanka), yet for decades the Royal Yacht Squadron refused to admit him on the grounds that he was a mere grocer.

Nevertheless, this mere grocer pioneered much of what we now call brand marketing, but can more accurately be described as self-promotion. Decades before Richard Branson or Donald Trump, Lipton knew the importance of creating an easily recognized image—in his case, a bushy mustache, floppy bow tie, and yachting cap—that would appeal to the masses. Nowhere were those personal trademarks more visible than at the America's Cup, which Lipton milked for maximum exposure. He was one of the first to spot the vast marketing potential of sports, especially when coupled with emerging forms of mass communication. He never won the Cup, but it didn't much matter. Paving the way for future industrialists-turned-team-owners, he mastered the art of offering newspaper reporters colorful quotes that elevated their copy and helped sell papers.

At the core of the Lipton brand was his own relentlessly cheery attitude. His personal story showed what was possible. Born in 1848, the son of Irish immigrants in the Glasgow slums, he left school and bought a steerage-class ticket to the U.S. At 18 he disembarked in New York and spent the next two years living hand-to-mouth. His break was landing a job at A.T. Stewart's huge dry goods store in Manhattan. Stewart's goods were similar to those Lipton had known in Scotland, but his emporium paid attention to presentation and offered various sizes and styles—all novelties of the day—which Lipton dutifully noted.

Lipton fell in love with the retail business and the way advertisements in the penny newspapers moved products. He returned to Glasgow at 22 with a fervent belief in advertising and presentation. Over the next two decades he turned his parents' butter and ham shop into a chain of 300 stores spanning Britain.

Despite D'Antonio's gifts as a writer and researcher, Lipton remains a veiled personality. He had a thousand friends but zero intimates. No grand love affairs or feuds ever cracked open his sunny public persona. His associate William Blackwood called him "the most self-centered and self-sufficient individual I have ever met in my life."

As he grew older, Lipton's carefully engineered personal brand showed its limitations. He couldn't bear to break through his genial façade to deliver bad news, so his staff began to dread his habit of visiting Lipton branches, spreading his trademark cheer, and then leaving—only to fire people by telegram days later. In 1914, Lipton Ltd. endured a bribery scandal in which some of its employees were found to have given kickbacks to military officers in exchange for business. Major shortfalls were concealed by Lipton's personal fortune. In 1927 he was ousted from the company he built. The grocery business disappeared in the mid-1980s, while the tea business was acquired by Unilever, under which it has thrived.

Lipton's story starts out as a period piece but turns out to be completely contemporary. Unfortunately, The Great Lipton lived in an age before *The Apprentice*, when there were few options for a flamboyant CEO outside the C-suite. Without him, though, there might never have been such a show. **B**

Beyond groceries and tea, Lipton's real product was himself—or at least the version of himself he presented

The Fame Game

Sir Thomas Lipton was one of the first CEOs to harness the power of sports as a self-promotional tool. (Would the death of George Steinbrenner, head of American Shipbuilding, make front-page news?) Here are others who have used the spotlight to boost their own brand. *—Ira Boudway*

Mark Cuban
After selling his Web radio company to Yahoo!, Cuban bought the Dallas Mavericks in 2000. Now he soaks up attention on the sidelines at every game.

Roman Abramovich
Having amassed a fortune during Soviet privatization, he became famous in Europe for his 2003 purchase of the Chelsea Football Club for $233 million.

Ted Turner
The TV magnate bought the then-sorry Atlanta Braves in 1976 to provide programming for TBS. Liberty Media owns the team now, but they play at Turner Field.



THOMAS NORTHCUT/GETTY IMAGES; FREDERICK M. BROWN/GETTY IMAGES; WENN.COM; HUGH DILLON/WENN

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FSC Mixed Sources

Pete Carroll

"Some people said I was crazy to leave, but in my heart I knew I wanted the challenge of competing at that level again"

The pro-football washout turned college gridiron champ on leaving USC to return to coaching in the NFL—this time with the Seahawks



I had been head coach of the New York Jets and the New England Patriots. In both cases, I was fired. I didn't know if anyone would hire me again. I never lost faith in myself, I just wasn't sure if others would believe in me.

Getting fired made me come up with my own philosophy of coaching, my own belief system of what it took to win. When I became head coach of the [University of Southern California] Trojans, I was given the autonomy to put my philosophy into practice. Over the next nine years, I had the time of my life. We built one of the most dominant football programs in the country—winning seven straight Pac-10 titles and two national championships.

There was never going to be a good time to leave. It would have been easier to stay. The fact that we were under investigation by the NCAA had nothing to do with my decision to leave. I've been dealing with it for five years—I was numb to it. The way they come at you, you really do feel you're guilty until proven innocent. It's unfortunate.

The NFL is different. That's all I'll say. I had been approached a few times by the NFL over the years, but I never felt there was the right setting to support my approach. Seattle allowed me that.

The most difficult thing was saying goodbye to the kids. I could probably never enjoy any place more than USC. I was happy there, but the level of seriousness in the NFL is different from college. It's the highest level of competition, the most difficult, and therefore also the most rewarding. Some people said I was crazy to leave, but in my heart I knew I wanted the challenge of competing at that level again.

There's no question that the years of working at USC gave me the confidence to coach differently this time around. If you structure your life around a relentless pursuit of the competitive edge—always competing to be the best you can be—you'll win in sports, or business, or parenting, or any other situation. I have a much better sense of my own belief system than the last time I coached in the NFL. B

—*As told to Diane Brady*

PHOTOGRAPH BY MIKE MCGREGOR FOR BLOOMBERG BUSINESSWEEK

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